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## Negotiable Instruments—A Comparison of Washington Law and Uniform Commercial Code Article 3 [Part 3]

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# NEGOTIABLE INSTRUMENTS—A COMPARISON OF WASHINGTON LAW AND UNIFORM COMMERCIAL CODE ARTICLE 3

RICHARD COSWAY\*

*The following article is the third in a series by Professor Richard Cosway on negotiable instruments in which he compares existing Washington law with Article 3 of the Uniform Commercial Code. Previous articles on Article 3 have appeared in 38 Wash. L. Rev. 501 (1963) and 38 Wash. L. Rev. 769 (1963).*

Section 3-205. RESTRICTIVE INDORSEMENTS. An indorsement is restrictive which either

- (a) is conditional; or
- (b) purports to prohibit further transfer of the instrument; or
- (c) includes the words "for collection," "for deposit," "pay any bank," or like terms signifying a purpose of deposit or collection; or
- (d) otherwise states that it is for the benefit or use of the indorser or of another person.

Though the mere utterance of the words "conditional indorsement" or "restrictive indorsement" strikes terror in most law students, there has been surprisingly little litigation arising out of such indorsements. Indeed, there is only one decision on the problem, and it<sup>1</sup> will be discussed in connection with the succeeding section of the Code. The only other authority is the Bank Collection Code which declares that certain indorsements are restrictive.<sup>2</sup> The classifications there stated are consistent with this section, and with those U.C.C. sections which will supplant the Bank Collection Code [4-201, 4-203, and 4-205 (2)].

Section 3-206. EFFECT OF RESTRICTIVE INDORSEMENT.

(1) No restrictive indorsement prevents further transfer or negotiation of the instrument.

(2) An intermediary bank, or a payor bank which is not the depository bank, is neither given notice nor otherwise affected by a restrictive indorsement of any person except the bank's immediate transferor or the person presenting for payment.

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<sup>1</sup> Follett v. Clark, 19 Wn.2d 518, 143 P.2d 536 (1943), 19 WASH. L. REV. 110 (1944).

<sup>2</sup> WASH. REV. CODE § 30.52.040 [Hereinafter cited as RCW].

(3) Except for an intermediary bank, any transferee under an indorsement which is conditional or includes the words "for collection," "for deposit," "pay any bank," or like terms (subparagraphs (a) and (c) of section 3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such transferee is a holder in due course if he otherwise complies with the requirements of section 3-302 on what constitutes a holder in due course.

(4) The first taker under an indorsement for the benefit of the indorser or another person (subparagraph (d) of section 3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such taker is a holder in due course if he otherwise complies with the requirements of section 3-302 on what constitutes a holder in due course. A later holder for value is neither given notice nor otherwise affected by such restrictive indorsement unless he has knowledge that a fiduciary or other person has negotiated the instrument in any transaction for his own benefit or otherwise in breach of duty (subsection (2) of section 3-304).

Two provisions of the NIL<sup>3</sup> are generally thought to mean that persons holding paper under restrictive indorsement are necessarily in the same position vis-a-vis the obligor as the restrictive indorser. Such holders are not due course holders. *Follett v. Clark*<sup>4</sup> is a startling illustration. The payee of a note had indorsed it, "Pay to the order of (Follett) for collection pursuant to the resolution of Trustees..." Before Follett had collected, however, the payee, a bank, had been dissolved. In a claim on the note subsequently pressed by Follett, he was denied recovery because the payee (restrictive indorser) could not have recovered after it had been dissolved.

The Code is much less explicit than the NIL, and in particular it does not repeat the provision found controlling in the *Follett* decision.<sup>5</sup> The emphasis of the Code is in an entirely different place, since the interests of the restrictive indorser or of the beneficiary of the restrictive in-

<sup>3</sup> RCW 62.01.037. [UNIFORM NEGOTIABLE INSTRUMENTS LAW § 37, hereinafter cited NIL] and RCW 62.01.047 [NIL § 47].

<sup>4</sup> 19 Wn.2d 518, 143 P.2d 536 (1943), 19 WASH. L. REV. 110 (1944).

<sup>5</sup> "A restrictive indorsement confers upon the indorsee the right to bring any action thereon that the indorser could bring..." RCW 62.01.037.

dorsement<sup>6</sup> seem to be its sole concern. So long as these interests are not impinged, the Code does not spell out the precise relationship between the indorsee and the obligor, until the indorsee has paid value consistently with the indorsement. That is to say, under the Code, Follett would clearly be able to recover as a holder in due course if he could show that he had in fact paid the payee for the note. Until this payment, though, he would not take for value and thus would be subject to defenses valid against the payee.<sup>7</sup> This is not the same thing, though, as saying that his capacity to sue is identical to that of the restrictive indorser, and this is in effect the rule of the *Follett* decision. The Code seems to leave this aspect of the problem unprovided for, but one is tempted to predict that with the loss of its underpinning statute, the *Follett* decision would not be followed. This unscientific hunch is supported by other decisions allowing assignees for collection to recover in their own names, even though the assignor was literally disqualified from suing on the assigned claim.<sup>8</sup>

The primary concern of the Code is to insure that in the most frequent pattern involving restrictive indorsements, bank collection of instruments, the restrictive indorser may expect his bank to protect his interests. He may not, however, expect other banks to look out for him, for they may ignore the restrictive indorsement,<sup>9</sup> and are bound only by actual knowledge of some breach of duty.<sup>10</sup> Once the bank of deposit has protected the restrictive indorser, as by crediting his account and allowing withdrawal thereof in good faith, that bank is a due course holder not subject to defenses assertable against the indorser.<sup>11</sup> These results were precluded by the NIL.

By a somewhat curious sequence of provisions, the Code first makes the indorsement, "Pay A only" restrictive,<sup>12</sup> and immediately recants by providing that no restrictive indorsement prevents further negotiation.<sup>13</sup> However, this matter is not vital because of its rarity.<sup>14</sup>

Finally, by protecting and emphasizing only the rights of the benefi-

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<sup>6</sup> *E.g.*, the indorsement "Pay A for collection, signed B" shows that B is retaining an interest in the paper, but an indorsement "Pay A in trust for C, signed B" created a beneficial interest in C, someone other than the restrictive indorser.

<sup>7</sup> UNIFORM COMMERCIAL CODE § 3-306, hereinafter cited by section.

<sup>8</sup> *E.g.*, *Marshall v. Pike*, 145 Wash. 348, 260 Pac. 531 (1927).

<sup>9</sup> Sections 3-206(2), 4-203, and 4-205(2). The effect of the indorsement "Pay any bank, banker or trust company" is governed by § 4-201(2).

<sup>10</sup> See § 3-304(2).

<sup>11</sup> Sections 3-305, 4-208 and 4-209.

<sup>12</sup> Section 3-205(b).

<sup>13</sup> Section 3-206(1) and Official Comment 2.

<sup>14</sup> BAILEY, *THE LAW OF BANK CHECKS*, § 5.11 (3d ed. 1962).

ciary under a restrictive indorsement, such as "Pay *A* in trust for *B*, signed *C*," the Code suggests that *A* and any indorsee from him are not necessarily subject to defenses good against *C*.<sup>15</sup>

Section 3-207. NEGOTIATION EFFECTIVE ALTHOUGH IT MAY BE RESCINDED. (1) Negotiation is effective to transfer the instrument although the negotiation is

- (a) made by an infant, a corporation exceeding its powers, or any other person without capacity; or
- (b) obtained by fraud, duress or mistake of any kind; or
- (c) part of an illegal transaction; or
- (d) made in breach of duty.

(2) Except as against a subsequent holder in due course such negotiation is in an appropriate case subject to rescission, the declaration of a constructive trust or any other remedy permitted by law.

Apart from the NIL provisions cited in the Official Comments as precursors,<sup>16</sup> there is no primary authority in Washington on the legal issue here covered. It is most important, nonetheless, to emphasize just what that legal issue is—the efficacy of a negotiation as transferring title to the paper. Observe that the contractual liability of the negotiating party (*e.g.*, the minor indorser) is not covered by this section but by another section of the Code.<sup>17</sup>

To an extent, this section merely continues the policy, generally recognized under the NIL, of denying to a person liable on an instrument the defense that a former holder of the paper is a person having power to disaffirm the transfer because of some incapacity or illegality.<sup>18</sup> As to such obligor, the transfer whether voidable or not is *effective*. It is the infant indorser, or the defrauded indorser, etc., who, having the power to cancel the indorsement, may raise the issue of the existence of this power.

The Code, however, is much more explicit than the NIL as to the effect of a want of capacity (or any other objection to the transfer listed in subsection (1)), particularly with respect to the holder in due course. Strangely enough, though it is quite clear that the purchaser

<sup>15</sup> The entire problem of the various forms of restrictive indorsements and their effect is ably discussed in Comment, *Restrictive Indorsements under the Uniform Commercial Code*, 24 U. PITT. L. REV. 616 (1963).

<sup>16</sup> RCW 62.01.022, 62.01.058, and 62.01.059 [NIL §§ 22, 58, and 59].

<sup>17</sup> Section 3-305.

<sup>18</sup> BRITTON, *BILLS AND NOTES*, § 160 (2d ed. 1961).

of chattels sold by an infant gets a voidable title which will ripen into a good title on resale to a bona fide purchaser,<sup>19</sup> there was substantial pre-Code doubt whether the purchaser of a negotiable instrument from an infant may, by negotiating to a due course holder, cut off the infant's power to disaffirm the transfer.<sup>20</sup> Under the Code, the outcome is clear—whether voidable or void, the transfer is sufficiently effective to allow a bona fide purchaser to cut off the transferor's rights to regain the instrument. This is true even though that same transfer may not be sufficient to create contractual liability on the transferor.<sup>21</sup> On the other hand, as to persons who are not holders in due course, the transfer may be disaffirmed in an appropriate proceeding by the transferor, and thus the paper may be repossessed by such party.

Section 3-208. REACQUISITION. Where an instrument is returned to or reacquired by a prior party he may cancel any indorsement which is not necessary to his title and reissue or further negotiate the instrument, but any intervening party is discharged as against the reacquiring party and subsequent holders not in due course and if his indorsement has been cancelled is discharged as against subsequent holders in due course as well.

Some, but by no means all, of the issues raised by reacquisition are covered by this section. Specifically, it relates to the relative position of the reacquirer (and those claiming through him in his capacity as reacquirer) and persons who became liable on the instrument between his first and second holding. The reacquirer has no claim against those intervening parties, for as to him they are discharged. The reason as stated in the official comment is that if the reacquirer were permitted to assert a claim against intervening parties, for breach of warranty or dishonor of the instrument, they would, in turn, claim against him for the liability created by his previous transfer.<sup>22</sup> However, the rule as actually stated is broader than this, for it prevents assertion of a claim by any reacquirer against any intervening party, even though there may be no offsetting liability. For example, the holder may transfer bearer paper without indorsing, or he may qualify his liability. This results in a limited form of responsibility on the holder's part to subse-

<sup>19</sup> RCW 63.04.250 [UNIFORM SALES ACT § 24]. For the Code's equivalent in the law of sales of goods, see § 2-403.

<sup>20</sup> 2 PATON'S DIGEST 2074 (4th ed. 1942).

<sup>21</sup> See discussion of § 3-305 at note 153 *infra*, and Comment, *Infants' Contracts and Their Enforcement*, 35 WASH. L. REV. 465, 469 (1960).

<sup>22</sup> Section 3-208, Official Comment.

quent takers, but if he should reacquire from them, by an unqualified indorsement, he is not in a position to enforce their liability on the instrument.<sup>23</sup>

The reacquirer may, as was true under the NIL, literally strike or expunge the signatures of intervening parties. Such an act discharges them even as against subsequent due course holders, but unless the signatures are thus canceled, a due course holder may enforce the liability of the signers. The observable cancellation is sufficient to suggest to the subsequent purchaser that the signer has been discharged.<sup>24</sup> It must be observed, though, that the mere circumstance of reacquisition does not put subsequent takers on notice of any defense or defect. Thus subsequent takers may rely on all signatures on the paper, unless they in fact know of the discharge.<sup>25</sup>

Consider the facts of *First Nat'l Bank v. Harris*.<sup>26</sup> Initially, five parties signed a note as co-makers, payable to *X*. Designating the makers as *A*, *B*, *C*, *D*, and *E*, the problem can be posed by stating that *C*, *D*, and *E* had signed for the accommodation of *A* and *B*. As among these five parties, *C*, *D*, and *E* were sureties and *A* and *B* were principals. While we do not know exactly what occurred, we do know that *X* indorsed the instrument. However, the plaintiff did not purchase the instrument from *X*. Instead, he purchased it from *A* and *B*. The issue was whether, in such circumstances, the plaintiff could enforce the liability of the sureties, *C*, *D*, and *E*. The court held that he could not, because the fact that *A* and *B* (co-makers) were in possession of the note with the payee's indorsement suggested payment. For this and other reasons, the court announced a flat rule that a maker who comes into possession of his paper may not reissue it so as to bind an accommodation party.

Observe that section 3-208 does not govern the outcome of the *Harris* case, because *C*, *D*, and *E* were not *intervening* parties. Several Code sections are involved,<sup>27</sup> particularly section 3-602. The policy behind the presently discussed section, 3-208, suggests, however, that unless it appeared that the plaintiff knew of *C*, *D*, and *E*'s status as accommodation parties, there is nothing about the apparent reacquisition of the note which requires the conclusion that the note has been paid and that it cannot be reissued.

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<sup>23</sup> BRITTON, *op. cit. supra* note 18, at 323, 689-98.

<sup>24</sup> *Cf.* § 3-602.

<sup>25</sup> Sections 3-304(1) (b) and 3-602.

<sup>26</sup> 7 Wash. 139, 34 Pac. 466 (1893).

<sup>27</sup> Sections 3-415, 3-601(1) (d), 3-601(3), 3-602, and 3-603.

Turning to aspects of reacquisition which are not covered by the present section, one may generalize that section 3-208 does not spell out the relationship between the reacquirer and those who were liable to him at the time he first held the paper. Usually, the arguments arising between such persons involve the question of whether the reacquirer can better the position he formerly held by claiming through an intervening due course holder. Another Code section is quite explicit about the circumstances under which a reacquirer may not make such a claim.<sup>28</sup> Except as expressly provided therein, a reacquirer from a due course holder may assert the rights of that holder.

A very common assumption is made that in any and all events the reacquirer may at least reassume the rights he formerly had against prior parties.<sup>29</sup> The facts presented in one Washington case, *First Nat'l Bank v. Dotson*,<sup>30</sup> show that such an assumption is not always valid. There, the maker had been induced by fraud on the part of the payee to sign a note. The payee had subsequently transferred by indorsement to an accomplice (who, of course, was subject to the defense of fraud). The accomplice then pledged the note with the plaintiff bank to secure a legitimate indebtedness. At that point, then, the plaintiff became a holder in due course to the extent of its lien, and to that extent would be free of the defense of fraud. The plaintiff, though, returned the instrument to the pledgor (the accomplice) who fruitlessly sought to collect from the maker. On his failure to collect, the accomplice returned the instrument to the plaintiff, but by this time the note had matured and, if the circumstances at the time of this taking are determinative, the plaintiff cannot now be a holder in due course. Thus the issue arises whether the plaintiff may reassert its former due course holder status, and this, said the court, posed a factual question for the jury. If the plaintiff merely delivered the instrument over to the accomplice as an agent to proceed to collect, he had not lost his due course holder rights. If, on the other hand, the plaintiff had surrendered his lien at the time of this return, these lien rights are terminated and cannot be reassumed.

The Code is not addressed to this particular problem, and no different result is to be predicted under it. The issue, though, ought to be pinpointed to illustrate why this reacquisition is different from that visual-

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<sup>28</sup> Section 3-201.

<sup>29</sup> *Dittmar v. Frye & Co.*, 200 Wash. 467, 93 P.2d 717 (1939); *Carr v. Bonthius*, 79 Wash. 282, 140 Pac. 339 (1914).

<sup>30</sup> 128 Wash. 450, 222 Pac. 886 (1924).



ized by the presently discussed section. Section 3-200 speaks to the situation in which a holder transfers the paper to a subsequent holder and then retakes it from him. The facts of the *Dotson* case were that the holder had returned it to a former holder and regained it from that holder. These circumstances are ambiguous, because such a return may manifest a surrender of rights on the paper. Retaking paper from subsequent purchasers is not ambiguous in this sense for it does not suggest any possibility of surrender of rights formerly held.

Section 3-301. RIGHTS OF A HOLDER. The holder of an instrument whether or not he is the owner may transfer or negotiate it and, except as otherwise provided in Section 3-603 on payment or satisfaction, discharge it or enforce payment in his own name.

This section of the Code does not substantially depart from previous authority. It applies to any *holder*, and this means a person in possession of an instrument payable to him or his order, or indorsed to him or his order, or payable to bearer.<sup>31</sup> He, in sum, is the person who comes within the contracts stated on the instrument. That the holder might not be the owner is illustrated by *Stinson v. Sachs*,<sup>32</sup> where a principal was permitted to recover on an instrument on which the agent was the designated payee. In such a situation, if the agent was in possession of the instrument, he would be the *holder*, and the principal would not. The major difference in the right to enforce the obligations on the paper is covered by section 3-307 and will be discussed in conjunction with that section.

It has been held in Washington that the holder, as the term is here used, may recover on paper consistently with the rules here stated. For example, a married woman has been permitted to maintain an action on paper payable to her, even though the note was actually community property.<sup>33</sup> A complaint need not allege that the plaintiff is the holder where the note is set forth and the plaintiff is the named payee.<sup>34</sup> Other illustrations are found below.<sup>35</sup>

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<sup>31</sup> Section 1-201(20). Cf. RCW 62.01.191 [NIL § 191].

<sup>32</sup> 8 Wash. 391, 36 Pac. 287 (1894).

<sup>33</sup> Nance v. Woods, 79 Wash. 188, 140 Pac. 323 (1914).

<sup>34</sup> Wockner v. King, 48 Wn.2d 83, 291 P.2d 649 (1955).

<sup>35</sup> *Croswaite v. Pierce*, 56 Wn.2d 725, 355 P.2d 160 (1960) (wife may not sue on note executed by husband payable to a bank); *Downie v. Cooledge*, 48 Wn.2d 485, 294 P.2d 926 (1956) (indorsee under a qualified indorsement is the holder); *West & Wheeler v. Longtin*, 118 Wash. 575, 204 Pac. 183 (1922) (check payable to broker as earnest money may be enforced by him); *Kilbourne v. Rathbun*, 91 Wash. 121, 157 Pac. 457 (1916) (partner may recover on note in settlement of the partnership without an accounting); *Metzger v. Sigall*, 83 Wash. 80, 145 Pac. 72 (1914) (payee of a note is

The rights stated in this section may, of course, be enjoyed by persons who technically are not holders. An assignment for purposes of bringing suit will, thus, enable the assignee to sue on the assigned note in his own name.<sup>36</sup> This principle can be extended, and an assignee allowed to settle claims on such paper for less than the full amount.<sup>37</sup> The Code covers such matters in section 3-201.

**Section 3-302. HOLDER IN DUE COURSE.** (1) A holder in due course is a holder who takes the instrument

- (a) for value; and
  - (b) in good faith; and
  - (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.
- (2) A payee may be a holder in due course.
- (3) A holder does not become a holder in due course of an instrument:
- (a) by purchase of it at judicial sale or by taking it under legal process; or
  - (b) by acquiring it in taking over an estate; or
  - (c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.
- (4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased.

The NIL's counterpart to this section<sup>38</sup> contains certain conditions which are required of the paper in order to qualify its being held in due course. Those requirements are:

- (1) The paper must be regular on its face.
- (2) The paper must be complete.
- (3) The paper must not be overdue.

Subsection (1) of the Code's provision on due course holders does not include these requirements, but it does substantially restate the condi-

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the holder); *Harris v. Johnson*, 75 Wash. 291, 134 Pac. 1048 (1913) (payee is real party in interest, even though he is to share proceeds with another); *Jamieson & McFarland v. Heim*, 43 Wash. 153, 86 Pac. 165 (1906); *Davis v. Erickson*, 3 Wash. 654, 29 Pac. 86 (1892).

<sup>36</sup> *McDaniel v. Pressler*, 3 Wash. 636, 29 Pac. 209 (1892).

<sup>37</sup> *Anderson v. Anderson*, 46 Wn.2d 903, 280 P.2d 252 (1955).

<sup>38</sup> RCW 62.01.052 [NIL §52].

tions which must be fulfilled by a holder in order to qualify him as one in due course. These are the requirements that he take for value, in good faith, and without notice of previous dishonor, defenses, or title claims against the paper. In addition, the three requirements stated above are subsumed under *notice*, so that the issue is not whether paper is regular, complete, or overdue, but whether the taker knows this. This point is emphasized in sections 3-302(1)(c) and 3-304.

The requirement that the holder take for value is refined in sections 3-303 and 4-209 and will be discussed under the former section.

"Good faith" is defined by the Code as "honesty in fact—in the conduct or transaction concerned."<sup>39</sup> At one time, the Code provided that a holder in due course must take "in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged." Because of criticism, generally centered on the fear that this would require reasonable conduct on the part of the taker, this provision was removed.<sup>40</sup> As the Code now reads, it does not depart from the rules announced by the Washington court with respect to good and bad faith.<sup>41</sup> The test to be applied has been dubbed the "blundering fool" or "white heart and empty head" doctrine.<sup>42</sup> This test is entirely subjective; did the taker act honestly? However, since evidence on this matter will inevitably be circumstantial, the trier of fact must keep in mind that he is trying to decide whether the taker did in fact behave honestly. Presumably, the conduct of the taker may be so gross that it is possible to conclude that no person could so act and still be acting in good faith. Under such circumstances, we may conclude that the particular taker did not act in good faith. Illustrative of this are purchasers who take at a discount. While mere purchase at a

<sup>39</sup> Section 1-201(19).

<sup>40</sup> See Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable Instruments Law with Those of Article 3 of the Proposed Commercial Code*, 49 Nw. U.L. Rev. 417, 431 (1954).

<sup>41</sup> First Nat'l Bank v. Moore, 148 Fed. 953 (9th Cir., 1906); Bowles v. Billik, 27 Wn.2d 629, 178 P.2d 954 (1947), 23 WASH. L. REV. 74 (1948), which seems to adopt the old requirement of due care, but the case is probably correct on its specific facts and actually applies the good faith test; Yakima Fin. Corp. v. Mullins, 138 Wash. 553, 245 Pac. 5 (1926); Inland Mortgage & Loan Co. v. Cady, 138 Wash. 52, 244 Pac. 123 (1926); Baumeister, Vollmer & Scott Bank v. Talbott, 129 Wash. 509, 225 Pac. 238 (1924); Lovell v. Dotson, 128 Wash. 669, 223 Pac. 1061 (1924); First Nat'l Bank v. Gunning, 127 Wash. 307, 220 Pac. 793 (1923); Banner Meat Co. v. Rieger, 125 Wash. 142, 215 Pac. 334 (1923); First Nat'l Bank v. Wiltzius, 122 Wash. 637, 211 Pac. 275 (1922); Guaranty Sec. Co. v. Coad, 114 Wash. 156, 195 Pac. 22, 197 Pac. 326 (1921); Citizens Bank & Trust Co. v. Limpricht, 93 Wash. 361, 160 Pac. 1046 (1916); Gibbens v. Nipp, 80 Wash. 332, 141 Pac. 689 (1914); Barker v. Sartori, 66 Wash. 260, 119 Pac. 611 (1911); McNamara v. Jose, 28 Wash. 461, 68 Pac. 903 (1902); Hansen v. Hoffman, 5 Wash. 792, 32 Pac. 747 (1893).

<sup>42</sup> Note, 4 BOSTON COL. IND. & L. J. 452, 456 (1963).

discount by itself may not equate with a failure to give value or a taking in bad faith,<sup>43</sup> the amount of the discount, taken in context with other facts, may lead to a finding of bad faith on the part of the discounter.<sup>44</sup> Another illustration can be found in the fine distinction between failure to investigate carefully (which, of course, is not tantamount to bad faith) and the apparent effort of a taker to close his eyes to the obvious. This latter action is bad faith.<sup>45</sup> Bad faith is simply not equatable to carelessness, however extreme, but it is equatable to affirmative effort by a purchaser of an instrument to obviate the effect of circumstances which are obvious to him.

A currently unsettled policy issue concerns the relative position of consumers who have signed negotiable paper and those purchasers (usually discounting finance companies or banks) who customarily purchase this paper from the payee-supplier. While it is apparent that a sham corporation set up to purchase paper from the purveyor of goods or services will not qualify as a due course holder,<sup>46</sup> it is much less clear what circumstances will place an established discounter in substantially the same position as a sham purchaser, that is to say, what circumstances will show that such a purchaser is, in substance, the payee.<sup>47</sup> The Code does not throw any more light on this difficult problem than did the NIL.

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<sup>43</sup> First Nat'l Bank v. Egbers, 130 Wash. 221, 226 Pac. 492 (1924); First Nat'l Bank v. Gunning, 127 Wash. 307, 220 Pac. 793 (1923); Farmers' State Bank v. Betcher, 115 Wash. 327, 197 Pac. 15 (1921); Moore & Co. v. Burling, 93 Wash. 217, 160 Pac. 420 (1916); Davis v. Hibbs, 73 Wash. 315, 131 Pac. 1135 (1913); Wells v. Duffy, 69 Wash. 310, 124 Pac. 907 (1912).

<sup>44</sup> Great W. Land & Improvement Co. v. Sandygren, 141 Wash. 451, 252 Pac. 123 (1927); McNamara v. Jose, 28 Wash. 461, 68 Pac. 903 (1902).

<sup>45</sup> Park v. Newell, 87 Wash. 431, 151 Pac. 783 (1915); Rohweder v. Titus, 85 Wash. 441, 148 Pac. 583 (1915). Scandinavian Am. Bank v. Johnston, 63 Wash. 187, 115 Pac. 102 (1911), has been criticized for its statement that "mere suspicion of an infirmity is insufficient to put the indorsee upon inquiry or to show that he is not a holder in good faith." It has been said that if this means that if the holder (purchaser) actually suspected an infirmity and made no inquiry, it is erroneous. "Confusion often arises from the fact that the distinction is not always clearly expressed, although probably intended, between suspicious circumstances and a suspicious purchaser." BRANNAN, *NEGOTIABLE INSTRUMENTS LAW* 775 (7th ed., Beutel 1948).

<sup>46</sup> Marsol Credit Co. v. West Coast Grocery Co., 191 Wash. 134, 70 P.2d 1046 (1937).

<sup>47</sup> See J. I. Case Credit Corp. v. Stark, 64 Wn.2d 481, 392 P.2d 214 (1964); Witenberg v. Sylvia, 35 Wn.2d 626, 214 P.2d 690 (1950); Allen v. Landre, 120 Wash. 171, 206 Pac. 845 (1922); Gwinn v. Ford, 91 Wash. 498, 158 Pac. 536 (1916), *affirming* 85 Wash. 571, 148 Pac. 891 (1915); Shedden v. Sylvester, 88 Wash. 348, 153 Pac. 1 (1915); Washington Trust Co. v. Keyes, 79 Wash. 61, 139 Pac. 638 (1914); Allenberg v. Wainwright, 62 Wash. 234, 113 Pac. 585 (1911). Cases in other jurisdictions are not harmonious; see Westfield Inv. Co. v. Fellers, 74 N. J. Super. 575 181 A.2d 809 (1962), 4 BOSTON COL. IND. & COMM. L. J. 452 (1963); G. M. A. C. v. Daigle, 225 La. 123, 72 So.2d 319 (1954), 53 MICH. L. REV. 877 (1955); Implement Credit Co. v. Elsinger, 268 Wis. 143, 66 N.W.2d 657 (1954); Note, *Finance Company as a Holder in Due Course*, 51 Ky. L.J. 134 (1962).

The Code also fails to focus specifically on another aspect of the problem. To what extent is a discounting purchaser a taker in bad faith because he had previously purchased paper that arose from transactions indistinguishable from the present one, and thus past transactions had demonstrated fraud on the part of the payee or breaches of contract by him?<sup>48</sup> The Code's entire concern is with notice of defects *in the particular paper purchased, or in series instruments*. It is difficult to distinguish the blundering fool from the sharp operator, but at some point the purchaser's familiarity with the operation of the payee and the difficulties experienced with transactions represented by similar, though unconnected, notes will surely constitute the basis for a finding of bad faith or, in Code terms, rank dishonesty.

Recently, the Washington Legislature by enacting the retail installment sales statute addressed itself to the social and economic policy issues involved here.<sup>49</sup> This statute specifically invalidates any provision by which buyer agrees not to assert defenses or claims arising out of the sale against the seller or seller's assignee.<sup>50</sup> Thus, the policy is to preserve consumer defenses even as against transferees of retail installment sales contracts. In one respect, however, this statute seems to leave open the possibility of negotiable notes executed by a retail installment purchaser, since it allows transactions consisting of a note secured by a mortgage.<sup>51</sup> Inasmuch as this recital does not destroy negotiability<sup>52</sup> and does not give notice of the mortgage,<sup>53</sup> it would appear that a holder in due course of such a note would be free of defenses or claims assertable against the seller. In the more typical conditional sales pattern, the conditional sales contract will embody all of the terms of the contract, but this can not be equated with knowledge that those terms have not been performed. Unless the conditional sales contract is of such complexity as to be non-negotiable,<sup>54</sup> due course holders of this paper may also be free of defenses.

The substitution in subsection (1)(c) of the requirement that a taker not *know* that paper is overdue for the NIL requirement that the paper be not in fact overdue has been alluded to in the opening para-

<sup>48</sup> The cases in note 47 *supra* are illustrative. Where a purchaser of a note was told before he purchased that the maker would probably contest the note, he obviously knows of sufficient suspicious circumstances to be precluded from thereafter taking in good faith. *Scandinavian Am. Bank v. Long*, 75 Wash. 270, 134 Pac. 913 (1913).

<sup>49</sup> RCW 63.14.

<sup>50</sup> RCW 63.14.150. [See § 9-206 and Comments].

<sup>51</sup> RCW 63.14.020.

<sup>52</sup> Section 3-112; Section 3-105.

<sup>53</sup> Section 3-304(5).

<sup>54</sup> Section 3-112.

graph of this discussion, and will be discussed in connection with section 3-304. At this point, however, it should be that paper with a fixed maturity date seems to carry notice of maturity on its face. While a purchaser may take the paper any time before this date, however near to maturity, and be a due course holder,<sup>55</sup> he may not take the paper after that date.<sup>56</sup>

The nine words of sub-paragraph (2), stating that a payee may be a holder in due course, will end a much discussed problem. Prior to adoption of this Code provision, there were substantial obstacles to any holding which permitted a person designated as payee of an instrument to be a due course holder, even though he was completely insulated from any participation in or knowledge of a defense. The Washington court espoused the approach that the payee may not be a due course holder,<sup>57</sup> except where the paper was originally purchased by a remitter<sup>58</sup> or was payable on its face to joint payees and indorsed by one over to the other.<sup>59</sup> The Code makes these distinctions unnecessary.

Subsection (3) enumerates particular situations in which a holder of paper ought to stand in the shoes of his transferor.<sup>60</sup> While one may take paper in payment of or as security for an antecedent debt and be a due course holder,<sup>61</sup> he may not become a due course holder by acquiring the paper through legal process designed to collect that debt.

Subsection (4) is merely the articulation of a general rule which is most frequently applied under section 3-201(2). It states that a purchaser of only a limited interest is a holder in due course only to the extent of the interest purchased.<sup>62</sup>

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<sup>55</sup> *Washington Nat'l Bank v. Pierce*, 6 Wash. 491, 33 Pac. 972 (1893).

<sup>56</sup> See *Higgins v. Radach*, 12 Wn.2d 628, 123 P.2d 352 (1942); *Morisse v. Salvesson*, 165 Wash. 157, 4 P.2d 852 (1931); *Burt v. Schoening*, 138 Wash. 187, 244 Pac. 381 (1926); *Spencer v. Alki Point Transp. Co.*, 53 Wash. 77, 101 Pac. 509 (1909) (in terms of dishonor). *Gordon v. Decker*, 19 Wash. 188, 52 Pac. 856 (1898); *Murray v. Reed*, 17 Wash. 1, 48 Pac. 343 (1897). That one may take after dishonor, but without notice thereof, and be a due course holder, see *Ladd & Tilton Bank v. Small*, 126 Wash. 8, 216 Pac. 862 (1923).

<sup>57</sup> *Ladd & Tilton Bank v. Small*, 126 Wash. 8, 216 Pac. 862 (1923); *Bowles v. Clark*, 59 Wash. 336, 109 Pac. 812 (1910), *overruled*, *Kohler v. First Nat'l Bank*, 157 Wash. 417, 289 Pac. 47 (1930).

<sup>58</sup> *Kohler v. First Nat'l Bank*, *supra* note 57.

<sup>59</sup> *State Bank v. Pacific Grain Co.*, 125 Wash. 149, 215 Pac. 350 (1923).

<sup>60</sup> In accord and illustrative is *Shuey v. Holmes*, 20 Wash. 13, 54 Pac. 540 (1898) (bank receiver stands in the position of the bank).

<sup>61</sup> Section 3-303. The security holder is a holder for value only to the extent of the indebtedness. Section 3-201. Thus parol may be used to show that a particular instrument, though indorsed in blank, was transferred only for security. *Keeler v. Commercial Printing Co.*, 16 Wash. 526, 48 Pac. 239 (1897). If there is no defense, the holder recovers the full amount of the instrument. *Hillman v. Stanley*, 56 Wash. 320, 105 Pac. 816 (1909).

<sup>62</sup> *Cf. Hillman v. Stanley*, 56 Wash. 320, 105 Pac. 816 (1909) where there was no defense to the paper, thus the holder recovered in full even though he held as pledgee only.

Once the position of due course holder has been attained, this status should not be lost by subsequent events. Thus, if a holder has purchased paper without knowledge of existing defects, he will be able to preserve his due course status even though he subsequently learns of the defects. A Washington case which contains contrary dicta should not be followed.<sup>63</sup> The Code, though, seems to contain one departure from this rule when it deals with a reacquirer who, as former holder, at any time had knowledge of a defense.<sup>64</sup> This provision may be read as depriving this particular reacquirer of his due course holder status.

Section 3-303. TAKING FOR VALUE. A holder takes the instrument for value

- (a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or
- (b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or
- (c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

The concept of "bona fide purchaser for value" or "holder in due course" seems to be founded on fundamental principles of fairness so as to protect one who, acting innocently on an apparent state of facts, has so changed his position by an outlay of money, property, or effort that it is unjust to defeat his expectation. This policy, when taken as a starting point for a discussion of *value*, has resulted in the need for distinguishing between value and consideration in two important contexts. The first concerns promises, and the second deals with past consideration. Both situations are covered by this section of the Code.

If some outlay which will result in loss upon failure of the payor's expectation is the test for *value*, it is at once apparent that a person who has merely promised performance and not yet performed can not

<sup>63</sup> American Nat'l Bank v. National Bank of Commerce, 132 Wash. 490, 232 Pac. 295 (1925). Cf. Union Inv. Co. v. Rosenzweig, 79 Wash. 112, 139 Pac. 874 (1914); American Sav. Bank & Trust Co. v. Helgesen, 64 Wash. 54, 116 Pac. 837 (1911), *aff'd*, 67 Wash. 572, 122 Pac. 26 (1912) (Addition of words "without recourse" after notes have been acquired does not let in defenses. Paranthetically, the presence of those words in the original indorsement would not deprive the holder of due course status. RCW 62.01.038 [NIL § 38]. The Code does not explicitly cover this point.)

See also Broadway Bank v. Whittaker, 177 Wash. 62, 30 P.2d 993 (1934) (the status of a holder in due course of a note pledged as security is not altered by the fact that a partial payment and renewal note are taken on the secured note).

<sup>64</sup> Section 3-201 (1).

usually be a taker for value. This person can prevent loss by the simple expedient of not performing his own promise. While he loses the performance which he expected, this is not the sort of loss which is equatable to a change of position on his part. Thus, section 3-303(a) takes as its departure the position that performance, not the promise thereof, is typically the giving of value. The concept of promise as consideration in bilateral contracts is inapplicable to questions of value, insofar as bona fide purchases and due course holding are concerned.

This concept has had its most frequent application where credit has been given by a bank on the basis of a check, note, or draft. The authorities do not agree on this question,<sup>65</sup> but the dominant view is that the giving of credit is not the giving of value.<sup>66</sup> While the Code retains this position, one exception is made. Where credit is "available for withdrawal as of right," it constitutes the giving of value.<sup>67</sup> Some Washington decisions seem to apply this exception to the ordinary bank deposit situation,<sup>68</sup> even though a right of charge-back existed, and the Code is, in the writer's opinion, not explicit regarding the circumstances which will result in a credit "available for withdrawal as of right." But it is believed that the existence of the ordinary bank deposit, with a right of charge-back on failure to collect, will not constitute the bank a holder for value.<sup>69</sup>

The creation of an irrevocable credit would be treated differently from ordinary credits. Merely creating such credit would be the giving of value, since the obligation must be performed irrespective of lack or failure of consideration. This situation not only falls precisely within the provisions of article 4<sup>70</sup> but it is also within the ambit of paragraph (c) of section 3-303. Thus, a bank, certifying a check or issuing its own negotiable draft, takes for value when it creates the obligation and not when it performs.<sup>71</sup> Because a bank may not avoid its obligation as against a due course holder, it is in precisely the same position as it would have been in, had it paid in the first place.

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<sup>65</sup> BRITTON, *BILLS AND NOTES* § 97 [2d ed. 1961].

<sup>66</sup> It is at once apparent that a bank which takes an instrument for collection, even though provisional credit is given, is not a holder for value within this rule. *Spokane State Bank v. Pitner*, 114 Wash. 177, 194 Pac. 969 (1921) so holds. There is, however, a potentially misleading statement in *McDaniel v. Pressler & Anderson*, 3 Wash. 636, 29 Pac. 209 (1892) that, "[A]n assignment for purpose of collection is an assignment for a valuable consideration." This sentence is obiter, and ought not be followed.

<sup>67</sup> Section 4-208(1)(b). See also § 4-209.

<sup>68</sup> *National Bank of the Republic v. Hines*, 112 Wash. 352, 192 Pac. 899 (1920); *Vickers v. Machinery Warehouse & Sales Co.*, 111 Wash. 576, 191 Pac. 869 (1920).

<sup>69</sup> See BAILEY, *LAW OF BANK CHECKS* § 4.6 (3d ed. 1962).

<sup>70</sup> Sections 4-208 and 4-209.

<sup>71</sup> *Acme Fin. Co. v. Zapffe*, 161 Wash. 312, 296 Pac. 1050 (1931).



Another area in which efforts to equate value and consideration frequently occur is in respect to the antecedent debt problem. It is arguable that a person taking an instrument or property as payment of an antecedent debt does not take for value, since by a reinstatement of the debt he can be restored to his previous position just as the person who has merely promised to perform may protect himself by not performing.<sup>72</sup> There are areas of law where this argument is accepted, *i.e.* doctrines relating to purchasers of trust property sold in breach of trust.<sup>73</sup> However, the Code, fully consistent with previous uniform statutes,<sup>74</sup> takes a contrary approach. An antecedent debt is value, whether an instrument is taken in payment of or as security for such a debt. There is no immediately apparent reason why an antecedent debt must be a debt of the transferor of the paper, and a Washington decision which seems to require this is suspect.<sup>75</sup> In order to be consistent with cases in which consideration was in issue, contrary holdings can be anticipated.<sup>76</sup>

Once a position has been taken with respect to the types of problems just discussed, it becomes necessary to evolve a rule which will cover the situation where a part of the promised price has been paid. The Code rule, consistent with previous authority,<sup>77</sup> is that value has been given only to the extent that one has performed, and a person becomes

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<sup>72</sup> Long v. McAvoy, 133 Wash. 472, 233 Pac. 930 (1935).

<sup>73</sup> Tucker v. Brown, 20 Wn.2d 740, 150 P.2d 604 (1944).

<sup>74</sup> RCW 62.01.025 [NIL § 25]; RCW 63.04.755 [UNIFORM SALES ACT § 76]; *Love-ring v. Pacific Fruit Package Co.*, 162 Wash. 445, 298 Pac. 693 (1931); *German-American Bank v. Wright*, 85 Wash. 460, 148 Pac. 769 (1915); *American Sav. Bank & Trust Co. v. Helgesen*, 64 Wash. 53, 116 Pac. 837 (1911), *aff'd*, 67 Wash. 572, 122 Pac. 26 (1912).

<sup>75</sup> *Stevens v. Naches State Bank*, 136 Wash. 137, 238 Pac. 918 (1925). To be distinguished is *S. R. McGowan Co. v. Carlson*, 79 Wash. 92, 139 Pac. 869 (1914), where the seller of stock in taking a note for the price, had the note made payable to a corporation. Since the corporation had parted with nothing, it was not a holder for value.

<sup>76</sup> *E.g.*, *Lincoln Trust Co. v. Spangler*, 121 Wash. 267, 209 Pac. 521 (1922), 32 YALE L. J. 405 (1922); *Lumbermen's Nat'l Bank v. Gross*, 37 Wash. 18, 79 Pac. 470 (1905). See § 3-408.

<sup>77</sup> *Credworth v. Shultz*, 254 Fed. 24 (9th Cir., 1918); *John Davis & Co. v. Bedgisoff*, 155 Wash. 127, 283 Pac. 665 (1930); *Brokaw v. Kunze*, 127 Wash. 593, 221 Pac. 590 (1923); *Hallock v. Nat'l Bank of Commerce*, 110 Wash. 385, 188 Pac. 479 (1920); *Old Nat'l Bank v. Gibson*, 105 Wash. 578, 179 Pac. 177 (1919), 17 MICH. L. REV. 703 (1919), 20 COLUM. L. REV. 351 (1920); *Citizens Bank & Trust Co. v. Limpricht*, 93 Wash. 361, 160 Pac. 1046 (1916); *German-American Bank v. Wright*, 85 Wash. 460, 148 Pac. 768 (1915); *Moyses v. Bell*, 62 Wash. 534, 114 Pac. 193 (1911); *Commercial Bank v. Toklas*, 21 Wash. 36, 56 Pac. 927 (1899). *Contra*, *American Sav. Bank & Trust Co. v. Dennis*, 90 Wash. 547, 156 Pac. 559 (1916), which was overruled in *Old Nat'l Bank v. Gibson*, *supra*. A caveat is in order concerning the *Gibson* decision, since one of the texts in the field of negotiable instruments cites it as adopting the rule that the giving of credit is the giving of value. OGDEN, NEGOTIABLE INSTRUMENTS 287 (5th ed. 1947). The decision does not support such a statement.

a holder for value, free of equities and defenses, only to the extent of that performance.<sup>78</sup> Because it is practically impossible to allocate withdrawals to a particular deposit in the case of bank credits, resort to a fiction is made by the Code. This fiction is the First Money In-First Money Out (FIFO) theory.<sup>79</sup>

Section 3-304. NOTICE TO PURCHASER. (1) The purchaser has notice of a claim or defense if

- (a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or
- (b) the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.

(2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

(3) The purchaser has notice that an instrument is overdue if he has reason to know

- (a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or
- (b) that acceleration of the instrument has been made; or
- (c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia is presumed to be thirty days.

(4) Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim.

- (a) that the instrument is antedated or postdated;

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<sup>78</sup> To be distinguished, of course, is the purchase at a discount. If the full price agreed upon is paid, even though it is a discounted price and thus less than the face value of the note, the purchaser is a due course holder (at least insofar as value is concerned) and may recover the face amount. *First Nat'l Bank v. Egbers*, 130 Wash. 221, 226 Pac. 492 (1924); *Williams v. Duke*, 125 Wash. 250, 215 Pac. 372 (1923); *Moore & Co. v. Burling*, 93 Wash. 217, 160 Pac. 420 (1916); *McNamara v. Jose*, 28 Wash. 461, 68 Pac. 196 (1902).

<sup>79</sup> Section 4-208(2).

- (b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof;
  - (c) that any party has signed for accommodation;
  - (d) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion;
  - (e) that any person negotiating the instrument is or was a fiduciary;
  - (f) that there has been default in payment of interest on the instrument, or in payment of any other instrument, except one of the same series.
- (5) The filing or recording of a document does not of itself constitute notice within the provisions of the Article to a person who would otherwise be a holder in due course.
- (6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

The concept of "notice" is legally significant in a multitude of ways and in many areas of law. When dealing with commercial paper, there seem to be two facets of notice to consider. It must first be considered what evidence is relevant in determining what an actor knew. (Note that we are concerned with actual knowledge—not that of a reasonably prudent man). What the actor in fact knew may remain a secret, but we discern what he probably knew by discovering that information which was readily available to him.<sup>80</sup> At this point, the second and more difficult element of notice arises. Notice is more complicated than simple awareness, since one may not fully appreciate those facts of which he is aware.<sup>81</sup> He may be expected to evaluate these facts, to draw inference from them, and, if you please, to read between the lines. The precise problem in formulating a substantive test for "notice" or "knowledge" seems to be how much information is the taker of a negotiable instrument expected to derive from between the lines?

Section 3-304 states rules of law which, where applicable, require or

<sup>80</sup> In the field of criminal law, the problem is well illustrated by comparing *State v. Hunter*, 11 Wn.2d 282, 118 P.2d 947 (1941) with *State v. Rubenstein*, 69 Wash. 38, 124 Pac. 135 (1912). The trier of facts is permitted to infer that a particular person knew those things which a reasonable man in his position would know. However, this may not be solidified into a rule of law that conclusively presumes that a particular person does know everything that a reasonably prudent person would know. Such a conclusive presumption would equate knowledge with due care in finding out.

<sup>81</sup> A reader may know a meaning for every word used in TENNYSON'S *LOVELY OF THE KING*, for example, and yet not appreciate the hanky panky going on between Lancelot and Guinevere, let alone the mysteries of the Holy Grail.

forbid as a matter of law a determination that the actor had notice of a critical circumstance merely because he had knowledge of some other closely related circumstance. However, this section must be read together with two or three other extremely important provisions of the Code.<sup>82</sup> In these other sections, awareness of facts is treated as "actual knowledge" of those facts, but notice of facts is broader and includes the inferences one may be expected to derive from apprehended facts.<sup>83</sup> The preceding sentence is somewhat ambiguous. It might have been worded, "but notice of facts is broader and includes inferences one may be expected to derive *reasonably* from apprehended facts" or even more pointedly, "notice includes the inferences a reasonably prudent man would draw from observed facts." Though such statements would remove some ambiguity, it is believed that they would not be warranted by the Code. While some doubt has developed as to whether due care or reasonably prudent conduct is to be the criterion for due course holding, it seems unwarranted. The present version of the Code has been considered by some to be sufficiently obscure on the effect of a lack of due care that the following additional amendment is warranted:

In any event, to constitute a notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith. If the

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<sup>82</sup> Of particular importance are §§ 1-201(25), 1-201(26), 1-201(27), and the comments thereto. These provisions are of such significance with regard to the notice requirement that they are set out at this point.

(25) A person has "notice" of a fact when (a) he has actual knowledge of it; or

(b) he has received a notice or notification of it; or

(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this Act.

(26) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when (a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

<sup>83</sup> See §1-201(25) (c), *supra* note 82.

purchaser is an organization and maintains within the organization reasonable routines for communicating significant information to the appropriate part of the organization apparently concerned, the individual conducting the transaction on behalf of the purchaser must have knowledge.<sup>84</sup>

An earlier version of the Code had incorporated into the good faith requirement a prescription requiring that reasonable commercial standards be observed. Fear that this embodied the rejected rule requiring reasonable care accounts for its removal from the present version. There seems no basis for apprehension that the Code requires reasonably prudent conduct<sup>85</sup> including investigation in the first instance. It is only after a purchaser has received information about some facts that any issue is raised as to a duty to inquire. Even at this point, the Code provides that a taker will have notice only when, from all facts and circumstances *he* (not a reasonably prudent person) had reason to know that a specific fact existed.<sup>86</sup>

The word "suspicion" crops up in many discussions of the problem of notice, and has been troublesome because the word has many shades of meaning.<sup>87</sup> One frequently reads that a ground for suspicion is not notice.<sup>88</sup> No fault can be found with this statement if it means that a particular holder is not bound to investigate those details which might appear suspicious to a reasonable man.<sup>89</sup> One is certainly not obligated to refute remote possibilities for which, while they might be true, there is no specific suggestion in particular facts.<sup>90</sup> On the other hand, once a prospective purchaser knows certain facts which carry an overpow-

<sup>84</sup> Penney, *New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code*, 62 COLUM. L. REV. 992, 999 (1962).

<sup>85</sup> But see Leary, *Article 3: Commercial Paper*, UNIFORM COMMERCIAL CODE HANDBOOK 110 (1964), where an objective standard is foreseen. For prior law, see *Scandinavian Am. Bank v. Johnson*, 63 Wash. 187, 115 Pac. 102 (1911). As Leary has observed, questions of notice become almost indistinguishable from those of good faith, and thus the discussion and cases cited in connection with section 3-302 are relevant. That separate issues are involved, though, is demonstrated in *Great W. Land & Improvement Co. v. Sandygren*, 141 Wash. 451, 252 Pac. 123 (1927). Failure to use due care is not, historically, tantamount either to bad faith or knowledge obtainable by its exercise. *Gray v. Boyle*, 55 Wash. 578, 104 Pac. 828 (1909).

<sup>86</sup> Cf. Leary, *supra* note 85.

<sup>87</sup> Zuckerman, *Negotiable Instruments—Purchaser in Good Faith*, 10 W. RES. L. REV. 177 (1959).

<sup>88</sup> *Kolmitz v. Jansen*, 130 Wash. 308, 226 Pac. 1023 (1924); *Keith v. Tsue Chong*, 119 Wash. 507, 205 Pac. 834 (1922).

<sup>89</sup> *Baumeister, Vollmer & Scott Bank v. Talbott*, 129 Wash. 509, 225 Pac. 238 (1924); *Farmers State Bank v. Betcher*, 115 Wash. 327, 197 Pac. 15 (1921); *Barker v. Sartori*, 66 Wash. 260, 119 Pac. 611 (1911).

<sup>90</sup> In every case there is a possibility of fraud or breach of contract. Business practices in some operations are perhaps a little more dubious than in others. Still one must not assume that every transaction by every business man in that field is tainted with fraud. Until some particular facts about the transaction of which the instrument in question are known to a prospective taker, he may assume the legitimacy of the tran-

ering implication that a defense exists, he may not close his eyes to this implication.<sup>91</sup> Indeed, such an inference need not be overpowering, since enough is shown to constitute notice if the facts actually known make the existence of a defense or claim probable.<sup>92</sup> In a sense, the purchaser of an instrument is on "constructive" notice insofar as he is required to draw inferences from facts which he knows. However, he is not otherwise subject to losing his status as a due course holder by constructive notice.<sup>93</sup>

To any extent that knowledge or notice is measured *subjectively*, there arises a field of inquiry as to whether information which had been known at one time, still existed in the mind of a purchaser at the time of purchase.<sup>94</sup> The Code specifically disclaims any position on this issue,<sup>95</sup> and no directly relevant Washington decision has been found, although the matter seems to have been adverted to.<sup>96</sup> At the other end of the chronological spectrum is the obvious rule that knowledge obtained after an instrument has been acquired is not relevant to the status of due course holder,<sup>97</sup> except in particular circumstances.<sup>98</sup>

saction. This may be broadened to include knowledge of defects in related or closely similar transactions by the same parties, but it surely goes no farther. See *Larsen v. Betcher*, 114 Wash. 247, 195 Pac. 27 (1921), where the court epitomizes one party's contention as being that no one can purchase a note given for the price of stock in good faith.

<sup>91</sup> *BRITTON, op. cit. supra* note 65, § 112.

<sup>92</sup> The distinction again is between "suspicious circumstances" and a "suspicious purchaser." See note 45 *supra*, and *Tucker v. Brown*, 20 Wn.2d 740, 150 P.2d 604 (1944).

<sup>93</sup> Section 3-304(5) is founded on this principle.

<sup>94</sup> It might be argued that once knowledge is shown to have been possessed by a particular person he is never afterwards free of such knowledge. This is analyzed in *GLANVILLE WILLIAMS, CRIMINAL LAW* § 63 (2d ed. 1961).

<sup>95</sup> Section 1-201(25).

<sup>96</sup> In *Gibbens v. Nipp*, 80 Wash. 332, 141 Pac. 689 (1914), the court seems to conclude that information received by a purchaser considerably prior to the purchase does not preclude due course holding, since such information would not make much impression on her so long as she was not then contemplating purchase. See *BRITTON, op. cit. supra* note 65, § 107.

<sup>97</sup> *Keith v. Tsue Chong*, 119 Wash. 507, 205 Pac. 824 (1922).

<sup>98</sup> In § 3-303, knowledge is relevant although acquired after purchase where it is acquired prior to performance of an executory promise. In § 3-201, dealing with the rights of reacquirers, notice of a defense or claim is mentioned, but it is not clear when this notice must have been possessed in order to be relevant. Sections 3-415(3) and 3-606 raise problems of whether notice that a signer is in fact an accommodation party requires a holder to recognize and guard against defenses characteristic of that capacity. Obviously, notice for this purpose might be significant even if acquired after an instrument is purchased but prior to the omission regarded as a defense to the accommodating party.

This note is not intended to be exhaustive of situations wherein knowledge or notice acquired subsequent to purchase are legally important, except insofar as the status *vel non* of due course holder is involved. Thus, by way of illustration, the sections on warranty which speak of knowledge of defenses are beyond the scope of this note, though they do refer to knowledge possessed by a holder as of the time he transfers, not as of the time he receives, the instrument. Sections 3-417 and 4-207.

The usual situation, where notice comes into existence after the acquisition and is

The first three subsections of section 3-304 spell out typical fact patterns which provide the basis for finding notice of defenses, claims against, or maturity of the instrument. Since notice of any of these circumstances precludes due course holding,<sup>99</sup> this section is obviously designed to elaborate the broader and undefined requirements posed in the definition of a holder in due course. Subparagraph (1)(a) restates in terms of notice categorical requirement of the NIL that an instrument be both complete and regular.<sup>100</sup> It has been doubted whether this Code statement is an improvement;<sup>101</sup> essentially the same factual questions remain to be solved. For example, it has been held, that a note is negotiable, for a sum certain, and complete and regular, even though the sum to be paid appears only in numbers in the margin or at the head, and is omitted from the blank space left for the number of dollars, in the body of the note.<sup>102</sup> One would predict that the Code would reach an identical result; indeed it seems an a fortiori conclusion. The contribution of the Code may be limited to converting what was an absolute requirement under the NIL into a requirement that is permissive of minor irregularities and omissions which do not suggest basic invalidity. Other illustrations of unusual remarks or omissions culled from Washington decisions appear in a note.<sup>103</sup> It may be generalized from these illustrations that one may not ignore extraneous remarks appearing on negotiable instruments, but in each case the effect of such remarks is to be determined by the notice they give to the purchaser.

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therefore irrelevant to due course holding, is illustrated by *Jamieson & McFarland v. Heim*, 43 Wash. 153, 86 Pac. 165 (1906).

<sup>99</sup> Section 3-302(1)(c).

<sup>100</sup> RCW 62.01.052 (1) [NIL § 52(1)].

<sup>101</sup> STEINHEIMER, MICHIGAN NEGOTIABLE INSTRUMENTS LAW AND THE UNIFORM COMMERCIAL CODE 64 (1960).

<sup>102</sup> *Citizens Bank v. Jones*, 127 Wash. 294, 220 Pac. 787 (1923), 22 MICH. L. REV. 607 (1924).

<sup>103</sup> *Doub v. Rawson*, 142 Wash. 190, 242 Pac. 920 (1927) (fact that a non-negotiable sales contract was payable at a finance company was not notice to the buyer that it would be assigned to that finance company); *Baumeister, Vollmer & Scott Bank v. Talbott*, 129 Wash. 509, 225 Pac. 238 (1924) (fact that the number "8," specifying the amount of interest, and the words "at maturity" were in different handwriting from the balance of the note was not material and did not preclude due course holding); *Mills v. Hayden*, 128 Wash. 67, 221 Pac. 994 (1924), (notations on a number of checks, payable to A, that they were "For F. Burdick, picker," etc. did not preclude the plaintiff, who took the check through A's indorsement, from becoming a due course holder). *First Nat'l Bank v. Sullivan*, 66 Wash. 375, 119 Pac. 820 (1911) is interesting for the Court did not discuss the effect of some rather substantial omissions from the body of the note.

*Cf. Hughes & Co. v. Flint*, 61 Wash. 460, 112 Pac. 633 (1911), discussed in connection with § 3-105, 38 WASH. L. REV. 501, 511 (1963).

The most significant case dealing with incomplete paper in Washington is *United Ry. & Logging Supply Co. v. Siberian Commercial Co.*, 117 Wash. 347, 201 Pac. 21 (1921), 22 COLUM. L. REV. 159 (1922), 70 U. PA. L. REV. 232 (1922), and previously discussed in connection with § 3-109, 38 WASH. L. REV. 501, 522 (1963).

One item which should be noted is the difference between purchase of an instrument containing blanks at the time of the purchase and purchase of complete paper which has, to the knowledge of the purchaser, been previously completed by someone other than the issuer. Under the NIL, some doubt existed as to the effect of filling blanks in the presence of a purchaser of an instrument.<sup>104</sup> The purchaser may not know of limitation of authority which has been exceeded by the person filling the blanks, and therefore, he should be considered a due course holder. Even though a purchaser of a note sees someone other than the maker complete the instrument, he may recover on the instrument as completed. This situation is covered by the specific provisions of section 3-304(4)(d), and also appears to be the Washington rule under the NIL.<sup>105</sup> Such a determination is consistent with other Washington decisions which state that a purchaser may assume honest conduct on the part of prior parties unless he has knowledge to the contrary.<sup>106</sup> It should be observed that section 3-304 is so worded as to also govern the rights of holders.

A related problem is presented when a drawee pays an instrument which, to his knowledge, has been completed by one other than the drawer. Consistent with the provision under discussion, the Code would also protect a drawee who pays in such circumstances, absent notice that the completion was not proper.<sup>107</sup> Alteration of an instrument is treated somewhat differently than completion. The Code provides that a purchaser has notice of a defense if the instrument "bears such visible evidence of . . . alteration . . . as to call into question its validity. . . ."<sup>108</sup> This suggests that alterations of substantial import (amount, name of the payee, etc.) which are made in obvious ways (different colored ink or in different handwriting, etc.) may *not* be assumed to have been made prior to the original issue of the instrument or with the consent of the maker. While this matter will be discussed below,<sup>109</sup> it should be ob-

<sup>104</sup> BRITTON, *op. cit. supra* note 65, at 199.

<sup>105</sup> *Ladd & Tilton Bank v. Small*, 126 Wash. 8, 216 Pac. 862 (1923), permitted recovery by the plaintiff who had seen blank checks filled in by one other than the maker. Because of the then Washington rule that a payee may not be a due course holder, the plaintiff's recovery was based on an estoppel.

In a comparable situation, where blanks had been filled in such a way as to indicate that they were not filled in at the time of the original issue, a purchaser was held to be a due course holder. *Baumeister, Vollmer & Scott Bank v. Talbott*, 129 Wash. 509, 225 Pac. 238 (1924).

<sup>106</sup> *Brokaw v. Kunze*, 127 Wash. 593, 221 Pac. 590 (1923) (the fact that a bank took bearer bonds to secure a husband's debt knowing that the wife had purchased them with separate property does not preclude holding in due course); *First Nat'l Bank v. Guardian Trust & Sav. Bank*, 117 Wash. 231, 200 Pac. 1095 (1921).

<sup>107</sup> Section 4-401(2)(b).

<sup>108</sup> Subsection (1)(a) of § 3-304.

<sup>109</sup> See discussion under §§ 3-307 and 3-407.



served here that only those alterations which raise questions as to the essential validity of the instrument are significant.<sup>110</sup>

Subsection (1)(b), dealing with the voidability of obligations, is supplemented by the provision of section 3-302, which states that a holder in due course must take without notice of *any* defense. Subsection (1)(b) is not exhaustive,<sup>111</sup> and the Official Comment's reference to set-off and counterclaim<sup>112</sup> has been criticized.<sup>113</sup> This matter will be discussed in connection with the sections describing the rights of holders.<sup>114</sup> The idea that a person who has notice of a defense is subject to that defense is so obvious that it scarcely needs stating. It has been illustrated by Washington decisions dealing with such matters as usury,<sup>115</sup> mistake,<sup>116</sup> failure of consideration,<sup>117</sup> and the related defense that the instrument is affected by gambling,<sup>118</sup> non-compliance with conditions precedent<sup>119</sup> or other conditions,<sup>120</sup> and the most frequently appearing defense (judged by reported cases), fraud.<sup>121</sup> With respect to fraud and misrepresentation, the case of *Peoples Bank & Trust Co. v. Romano Eng. Corp.*<sup>122</sup> warrants reconsideration. The facts suggest that a bank had purchased paper, knowing that the payee had made representations to

<sup>110</sup> Washington law appears to be in accord with this approach, even under the NIL. Thus, in *Chamberlain v. Geer*, 135 Wash. 340, 237 Pac. 719 (1925) the court had before it an instrument where the date was in a different ink from the balance. One cannot say that this was a clearly obvious alteration, for there was no clear evidence of erasure. One might, therefore, analogize this case to the *Baumeister* case, *supra* note 104 and permit recovery according to the instrument as it appears at the time of trial. It was not necessary to decide this, though, for recovery "according to the original tenor" was adequate protection to the plaintiff. On the issue of due course holding, the court emphasized that the appearance of the paper was not such as to arouse suspicion or to put a reasonable person on inquiry. Thus the requirement of regularity was transmuted into one of knowledge derived from irregularity.

<sup>111</sup> Braucher, *UCC Article 3—Commercial Paper—New York Variations*, 17 *RUTGERS L. REV.* 57, 68 (1962).

<sup>112</sup> Comment 3.

<sup>113</sup> Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable Instruments Law with Those of Article 3 of the Proposed Commercial Code*, 49 *Nw. U.L. REV.* 417, 436 (1954).

<sup>114</sup> Sections 3-305 and 3-306.

<sup>115</sup> *Fry v. Knouse*, 142 Wash. 500, 253 Pac. 802 (1927).

<sup>116</sup> *Naylor v. Lovell*, 109 Wash. 409, 186 Pac. 855 (1920).

<sup>117</sup> *Hamilton v. Mihills*, 92 Wash. 675, 159 Pac. 887 (1916); *Hamilton v. Ramage*, 89 Wash. 649, 155 Pac. 151 (1916); *Johnson County Sav. Bank v. Rapp*, 47 Wash. 30, 91 Pac. 382 (1907).

<sup>118</sup> *Ash v. Clark*, 32 Wash. 390, 73 Pac. 351 (1903). To the same effect is *RCW* 4.24.090.

<sup>119</sup> *Merrill v. Muzzy*, 11 Wash. 16, 39 Pac. 277 (1895).

<sup>120</sup> *Yakima Fin. Corp. v. Mullins*, 138 Wash. 553, 245 Pac. 5 (1926).

<sup>121</sup> *Bowles v. Billik*, 27 Wn.2d 629, 178 P.2d 954 (1947), 23 *WASH. L. REV.* 74 (1948); *Marsol Credit Co. v. West Coast Grocery Co.*, 191 Wash. 134, 70 P.2d 1046 (1937); *Inland Mortgage & Loan Co. v. Cady*, 138 Wash. 52, 24 Pac. 123 (1926); *First Nat'l Bank v. Wiltzius*, 122 Wash. 637, 211 Pac. 275 (1922); *Gwinn v. Ford*, 85 Wash. 571, 148 Pac. 891, *aff'd*, 91 Wash. 498, 158 Pac. 536 (1916); *Union Inv. Co. v. Rosenzweig*, 79 Wash. 112, 139 Pac. 874 (1914).

<sup>122</sup> 188 Wash. 290, 62 P.2d 445 (1936), *aff'd on rehearing*, 65 P.2d 688 (1937), 12 *WASH. L. REV.* 81 (1937), 37 *COLUM. L. REV.* 852 (1937).

the maker. Those statements or representations were, in fact, false, and the court held (in a divided opinion) that the bank was subject to the defense of fraud. This decision would seem erroneous unless the bank knew that the representations were false. Absent such knowledge or notice, the holding is inconsistent with the philosophy of either the NIL or Code. In fact, it is contrary in principle to a specific Code provision.<sup>123</sup>

The Code's elimination of constructive notice through filing<sup>124</sup> was previously discussed. However, there is a related problem of what might be called "imputed notice," worthy of mention at this point. The circumstances presenting this problem usually involve corporate activities of considerable size, where one employee may know facts not known to others. Under what circumstances is an employee's knowledge also the knowledge of the employer? The question is most easily answered negatively, and in the following circumstances knowledge is not imputed to the principal: (1) Where the agent is acting adversely to the principal's interest;<sup>125</sup> (2) Where it appears that the agent obtained the knowledge while clearly in some capacity other than as representative of the principal, particularly where the agent's interests are adverse to the principal;<sup>126</sup> and (3) Knowledge which was casually obtained under circumstances where the significance of that knowledge as affecting the rights of the principal is not obvious.<sup>127</sup> On the other hand, knowledge of an agent, certainly one who is under duty to forward such information to his principal,<sup>128</sup> received in the course of his agency will be imputed to the principal.<sup>129</sup> The Code adds a detail of great significance by providing a guideline for determining when an organization receives effective notice.<sup>130</sup> Notice (both in the sense of the notice received from notification and in the sense of necessary fact inferences from known facts) and knowledge of the *particular employee handling the transaction* are made determinative by this section, (so long as the organization has used reasonable care in passing along information received.)

<sup>123</sup> Subsection 4(b) of § 3-304.

<sup>124</sup> Subsection 5 of § 3-304.

<sup>125</sup> RESTATEMENT, AGENCY (2d) § 282 (1958); Guaranty Trust Co. v. Yakima First Nat'l Bank, 179 Wash. 615, 38 P.2d 384 (1934); Fry v. Knouse, 142 Wash. 500, 253 Pac. 802 (1927); German-American State Bank v. Soap Lake Salts Remedy Co., 77 Wash. 332, 137 Pac. 461 (1914).

<sup>126</sup> Hoppe v. First Nat'l Bank, 137 Wash. 41, 241 Pac. 662 (1925).

<sup>127</sup> Washington Nat'l Bank v. Pierce, 6 Wash. 491, 33 Pac. 972 (1893); cf. RESTATEMENT AGENCY (2d) § 276 (1958).

<sup>128</sup> RESTATEMENT AGENCY (2d) § 272 (1958).

<sup>129</sup> Hitt Fireworks Co. v. Scandinavian Am. Bank, 114 Wash. 167, 195 Pac. 13, 196 Pac. 629 (1921).

<sup>130</sup> Section 1-201 (27).

Another area of inquiry concerns the effects of notice or knowledge which does not emanate from the particular transaction or instrument, but instead is derived from similar or related transactions. Though the Code seems to be worded in terms of notice or knowledge of defects in, defenses to, or claims on the *particular* instrument, it is believed that notice of a defense or claim can be found when there exists a knowledge of defenses or claims arising out of connected or quite similar transactions. Where a bank purchases all notes that are given by customers to a jewelry salesman and the first 99 had been found to have been fraudulently obtained by the salesman, it is suggested that the bank is not a bona fide purchaser without notice of fraud on the purchase of the 100th note, if such note was also affected by fraud.<sup>131</sup> Thus, we have one mechanism that may be used to preclude financing operators from becoming holders in due course, a matter on which the Code is strangely silent.<sup>132</sup> In this regard, it should be noted that sometimes a "purchaser" of an instrument will, in fact, be so closely connected with the seller-payee of the instrument so as to be subject to defenses that are good against the payee<sup>133</sup> even though this purchaser had no positive evidence or knowledge of these defenses.

Subsection (2) deals with instruments negotiated by fiduciaries. At the very outset, it merits notice that the Washington legislature had seen fit to add a unique provision to the NIL that covers this fiduciary problem.<sup>134</sup> Two major differences exist between the Code's provision and that of the Washington statute. First, the Code governs *negotiations* by fiduciaries but not *fiduciarily drawn* paper, while the Washington statute governs both. Second, the Washington statute has adopted a policy protecting those persons who deal with fiduciaries which is much broader than that provided by the Code. Under both Code and statute provisions, the knowledge that a fiduciary is negotiating paper does not prevent due course holding,<sup>135</sup> but the knowledge of a purchaser that a fiduciary is violating his duty will subject the purchaser to this breach of duty.<sup>136</sup> The Code precludes due course holding whenever the purchaser is aware only that the transferor is using the instrument to pay his own private debt or for his own benefit. While some early Washing-

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<sup>131</sup> See *Johnson County Sav. Bank v. Rapp*, 47 Wash. 30, 91 Pac. 382 (1907).

<sup>132</sup> Note, *Finance Company as a Holder in Due Course*, 51 Ky. L.J. 134 (1962).

<sup>133</sup> *Marsol Credit Co. v. West Coast Grocery Co.*, 191 Wash. 134, 70 P.2d 1046 (1937).

<sup>134</sup> RCW 62.01.0195.

<sup>135</sup> Section 3-304(4) (e). *Hill Syrup Co. v. American Sav. Bank & Trust Co.*, 133 Wash. 501, 234 Pac. 11 (1925).

<sup>136</sup> *Pitzen v. Doubleday*, 5 Wn.2d 370, 105 P.2d 726 (1940).

ton decisions had adopted this rule,<sup>137</sup> the NIL amendment rejected it.<sup>138</sup> On balance, it would seem that the Code rule is preferable, since it is sufficiently unusual for an agent or fiduciary to pay his own debts by indorsing his principal's checks that this act can be equated to notice that something is amiss.<sup>139</sup>

Subsection (3) implements the section 3-302 requirement that a due course holder take without notice that paper is overdue. Instruments having a fixed maturity date will carry notice on their face, and no purchaser can take as a due course holder after the disclosed date.<sup>140</sup> Instalment notes come within this subsection so that under the Code one is precluded from becoming a due course holder if he takes with knowledge that an instalment has not been paid. However, a point of distinction is to be observed with regard to the instalment note. Because notes can be expected to circulate until the maturity of the final instalment, there may be due course holders, insofar as *unpaid* instalments are concerned, prior to final maturity, even though earlier instalments have in fact matured. What inferences must a purchaser draw when an instalment note is tendered to him after one or more

<sup>137</sup> *Farmers' Loan & Trust Co. v. Fidelity Trust Co.*, 86 Fed. 541 (9th Cir. 1898); *Rensselaer Valve Co. v. National Bank of Commerce*, 129 Wash. 253, 244 Pac. 673 (1924); *Hoffman v. Gottstein Inv. Co.*, 101 Wash. 428, 172 Pac. 573 (1918).

<sup>138</sup> RCW 62.01.0195 (1955) *Signature by agent, authority, notice of limitations*. Where a check or other negotiable instrument is drawn, made or indorsed in the name of or for a corporation, firm, association, estate or person hereinafter called principal by an officer, trustee, attorney or other agent or fiduciary, hereinafter called agent, to the personal order of such agent as payee or indorsee or to the order of a bank in which such agent keeps a personal account or to the order of any third person neither the fact that such check or other negotiable instrument is so drawn or indorsed, or is paid by the drawee, or is deposited in the personal account of such agent or is given by him or its proceeds used in payment of his private debt to the bank in which deposited or to any other person or is negotiated by him in any personal transaction shall singly or collectively be sufficient to put the depository or drawee bank or any other person, bank, firm or corporation upon inquiry as to the authority of such agent or constitute notice of an infirmity in the check or other negotiable instrument or defect in the title of the agent, in the absence of actual knowledge upon the part of such bank or person that such check or other negotiable instrument was drawn, indorsed, negotiated, deposited or paid without the authority of the principal.

The leading decision is *General Cas. Co. v. Seattle-First Nat'l Bank*, 42 Wn.2d 433, 256 P.2d 287 (1953). See also *Rice v. Peoples Sav. Bank*, 140 Wash. 20, 247 Pac. 1009 (1926); *Hill Syrup Co. v. American Sav. Bank & Trust Co.*, 133 Wash. 501, 234 Pac. 11 (1925); *Harden v. State Bank*, 118 Wash. 234, 203 Pac. 16 (1922); *Island Belt & S. S. Co. v. J. & M. Cafe*, 103 Wash. 263, 174 Pac. 19 (1918); *Fisk Rubber Co. v. Pinkey*, 100 Wash. 220, 170 Pac. 581 (1918); *National City Bank v. Shelton Elec. Co.*, 96 Wash. 74, 164 Pac. 933 (1917); *Barker v. Pfund*, 80 Wash. 143, 141 Pac. 327 (1914); *Mott Iron Works v. Metropolitan Bank*, 78 Wash. 294, 139 Pac. 36 (1914); *Spencer v. Alki Point Transp. Co.*, 53 Wash. 77, 101 Pac. 509 (1909); *Fidelity Trust Co. v. Palmer*, 22 Wash. 473, 61 Pac. 158 (1900).

<sup>139</sup> This has been the view under the UNIFORM FIDUCIARIES ACT, §§ 4 and 6.

<sup>140</sup> *Britton*, *supra* note 113, at 424; 72 BANKING L. J. 305, 311 (1955). See *Gordon v. Decker*, 19 Wash. 188, 52 Pac. 856 (1898) for the Washington rule, in accord.

It is to be noted that the NIL's presumption that indorsements were prior to maturity, relied on in *Myers-Shepley Co. v. Milwaukee Grain Elevator Co.*, 124 Wash. 583, 214 Pac. 1051 (1923) is not retained by the Code.

instalment dates have arrived? May he assume that they have been paid on time, or must he assume that they have not? Is inquiry required? Absent a custom he knows or should know, it is believed that the purchaser may assume that the instalments were paid when due, and thus become a due course holder of the unpaid instalment. However, where the custom is to indorse on notes any evidence of partial or instalment payments, the purchaser runs the substantial risk of being denied the status of a due course holder because the absence of an indorsement of payment may be construed as notice that no payment was made.<sup>141</sup> Certainly in such a situation, the purchaser cannot claim that he thought no payments were made and thus seek to be a holder in due course even as to overdue instalments.<sup>142</sup>

In the preceding discussion of the nonpayment of instalments, it is important to observe that the instalments referred to are instalments of principal. It is settled by both the Code<sup>143</sup> and pre-Code litigation<sup>144</sup> that nonpayment of interest, even if known to a purchaser, will not suggest a defense by the obligor to the principal sum, and a due course holding status is, therefore, not precluded.

Where nonpayment of interest occurs in a note having an acceleration clause which permits the advancing of maturity of nonpayment, it can be predicted that *if* the acceleration clause is worded in such a way as to appear automatic, *i.e.* on nonpayment of any instalment of principal or interest the whole sum shall be due, then a purchaser who knows of the occurrence of the accelerating event is not a holder in due course.<sup>145</sup> On the other hand, if the provision is worded in terms of giving an option to the holder to accelerate, (*i.e.* on nonpayment of interest, the holder may declare this note due) one may purchase with knowledge that the accelerating event has occurred and still be a due course holder, unless he knows that the maker had exercised the option.

Where a series of notes are involved, the Code provides that if one note has been defaulted and the purchaser is aware of this, then the

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<sup>141</sup> Cf. 2 PATON'S DIGEST 1976 (1942).

<sup>142</sup> BRITTON, *BILLS AND NOTES* 274 (2d ed. 1961).

<sup>143</sup> Section 3-304(4) (f).

<sup>144</sup> Britton, *op. cit. supra* note 142, at 276.

The Washington court has, however, occasionally suggested that nonpayment of interest, known to a taker, is a factor to be considered on the issue of good faith. *Shultz v. Crewdson*, 95 Wash. 266, 163 Pac. 734 (1917); *Ireland v. Scharpenberg*, 54 Wash. 558, 103 Pac. 801 (1909). The Code rejects this rule, returning to the rule initially adopted in Washington. *Spencer v. Alki Point Transp. Co.*, 53 Wash. 77, 101 Pac. 509 (1909).

<sup>145</sup> The existing authority in Washington, though, is contrary, because of the construction given to acceleration clauses. *Spencer v. Alki Point Transp. Co.*, *supra* note 144. See the discussion in connection with § 3-109, 38 WASH. L. REV. 501, 519 (1963).

purchaser cannot be a due course holder of any of the notes in the series.<sup>146</sup> It is believed that a purchase of only those notes in the series which have not matured will not insulate a purchaser from the effect of maturity of one or more. The purchaser can not be a holder in due course of any, so long as he has reason to know that he is purchasing a part of a series and that there has been default of one of the notes. This accords with the holding in one interesting Washington case.<sup>147</sup>

Demand instruments are governed by a rule all their own, since they are "due" when issued and thus arguably "overdue" an instant later. By Code<sup>148</sup> and previous legal provisions,<sup>149</sup> such treatment of demand of paper is not the case. One may purchase demand paper within a reasonable time after issue and without knowledge of a previous demand, if there was one, and still be a due course holder. The major contribution of the Code in this matter is its statutory edict that a reasonable time for a domestic check is presumed to be thirty days. Prior law has been most uncertain<sup>150</sup> in determining reasonable time, and under the Code there will remain a question of fact in any case other than the domestic check.

It is apparent from the preceding discussion that most of the details of subsection (4) are correlative to other specific provisions. No particular Washington authority exists with respect to the particulars contained in this subsection as to those matters discussed above. The Washington decisions are entirely in accord with subsection (4)(b),<sup>151</sup> and subsection (4)(c).<sup>152</sup> Both subsections (5) and (6) are new.

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<sup>146</sup> The Washington decisions are not clear on the point, perhaps because the facts do not always distinguish between notes in a series and notes of the same maker, otherwise unconnected. The Code, it is to be remembered, distinguishes the two by §§ (3)(a) and 4(f) of § 3-304. See *Guaranty Sec. Co. v. Coad*, 114 Wash. 156, 195 Pac. 22, 197 Pac. 326 (1921); *Spencer v. Alki Point Transp. Co.*, 53 Wash. 77, 101 Pac. 509 (1909).

<sup>147</sup> *Keene v. Behan*, 40 Wash. 505, 82 Pac. 884 (1905).

<sup>148</sup> Section 3-304(3) (c).

<sup>149</sup> 2 PATON'S DIGEST 1978 (1942); RCW 62.01.053 [NIL § 53].

<sup>150</sup> The decision in *German-American Bank v. Wright*, 85 Wash. 460, 148 Pac. 769 (1915) seems to have confused two principles, (a) the one here involved with respect to due course holding, and (b) the effect of delay in presentment on the liability of secondary parties. The time limits applicable for these two principles are not necessarily the same, though as it happens the Code's provisions are identical, insofar as the thirty-day time limit on the liability of drawers is concerned. Cf. §§ 3-304(3) (c), 3-503(2).

<sup>151</sup> *First Nat'l Bank v. Moore*, 148 Fed. 953 (9th Cir., 1906); *Garner v. F. T. Crowe & Co.*, 138 Wash. 584, 244 Pac. 970 (1926); *Cross v. Voss*, 132 Wash. 576, 231 Pac. 929 (1925); *Lovell v. Dotson*, 128 Wash. 669, 223 Pac. 1061 (1924); *Citizens Bank & Trust Co. v. Limpricht*, 93 Wash. 361, 160 Pac. 1046 (1916); *German-American Bank v. Wright*, *supra* note 150; *Washington Trust Co. v. Keyes*, 79 Wash. 61, 139 Pac. 638 (1914); *Moyes v. Bell*, 62 Wash. 534, 114 Pac. 193 (1911); *Gross v. Bennington*, 52 Wash. 417, 100 Pac. 846 (1909).

<sup>152</sup> *O'Brien v. Turner*, 174 Wash. 266, 24 P.2d 641 (1933); *Bank of Cal. v. Starrett*, 10 Wash. 231, 188 Pac. 410 (1920), 90 CENT. L. J. 394 (1920).

Section 3-305. RIGHTS OF A HOLDER IN DUE COURSE. To the extent that a holder is a holder in due course he takes the instrument free from

- (1) all claims to it on the part of any person; and
- (2) all defenses of any party to the instrument with whom the holder has not dealt except
  - (a) infancy, to the extent that it is a defense to a simple contract; and
  - (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
  - (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
  - (d) discharge in insolvency proceedings; and
  - (e) any other discharge of which the holder has notice when he takes the instrument.

This section considers the rights of the due course holder with respect to both ownership claims against the document and liability for contractual defenses. While the holder in due course was free from third party claims to the instrument under pre-Code law,<sup>153</sup> the availability of defenses against such a holder depended upon whether the defense was "real" or "personal." The fundamental choice in classifying between these two groups of defenses depended upon a policy choice, whether the protection of the obligor was more important than maintenance of a free flow of instruments by virtue of negotiability.

It is to be observed that the Code treats claims different from defenses. An illustration is the indorsement of an instrument by an infant which, though there seem to be no pre-Code Washington cases,<sup>154</sup> under the Code will (a) permit an infant to avoid contractual liability to the extent that he may do so on a simple contract, and yet (b) not enable him to recover the instrument from a transferee.<sup>155</sup>

<sup>153</sup> Thus, theft of bearer instruments gives rise to a right of the victim to recover the stolen instrument, but this right is not effective against a due course holder. *Hellar v. National City Co.*, 171 Wash. 585, 18 P.2d 480 (1933); *Bank of Cal. v. National City Co.*, 138 Wash. 517, 244 Pac. 690 (1926), *modified*, 141 Wash. 243, 251 Pac. 561 (1926), 25 MICH. L. REV. 794 (1927); *Fidelity Trust Co. v. Palmer*, 22 Wash. 473, 61 Pac. 158 (1900). An innocent transferee of notes takes free of a claim of a receiver or trustee in bankruptcy of the transferor that the notes were transferred in a fraudulent conveyance. *McNamara v. Farnsworth*, 106 Wash. 523, 180 Pac. 466 (1919).

<sup>154</sup> See Comment, *Infants' Contracts and Their Enforcement*, 35 WASH. L. REV. 465 (1960).

<sup>155</sup> Section 3-207.

Thus, an infant's claim to the instrument, which is based upon his power to rescind the transfer, is cut off, but his defense to liability may be retained.

With respect to other forms of incapacity, essentially the same dichotomy exists, and the availability of the defense is predicated on whether the incapacity is such as to make the obligation void.<sup>156</sup>

The effect of duress under the Code will depend upon the degree of threats or force used.<sup>157</sup> The Washington cases do not provide authority sustaining this distinction,<sup>158</sup> but the posture of the cases has not been such as to present the issue.

Similarly, the Code distinguishes between fraud which vitiates the contract entirely, and fraud which, because it does not go to the nature of the contract but to its inducement, makes the contract voidable. This distinction has been recognized in Washington, where the holdings are consistent that fraud in *factum*<sup>159</sup> (which makes the contract void and a nullity, a "real" defense) is to be distinguished from fraud in the inducement.<sup>160</sup>

Illegality, too, may be a real or personal defense, depending on the strength of the policy by which an instrument is declared illegal. Since

<sup>156</sup> Competence is usually equated to ability to manage one's own affairs, or transact business. *Peoples State Bank v. Driscoll*, 143 Wash. 401, 255 Pac. 134 (1927); *American Sav. Bank & Trust Co. v. Peterson*, 112 Wash. 101, 191 Pac. 837 (1920); *Bell v. Waudby*, 4 Wash. 743, 31 Pac. 18 (1892). Intoxication is a defense as against a non-due-course-holder. *Gibson v. Feeney*, 66 Wash. 531, 120 Pac. 97 (1912). It is arguable that intoxication can become so disabling as to constitute a real defense. BRANNAN, *NEGOTIABLE INSTRUMENTS LAW* 758 (7th ed., Beutel ed. 1948).

There is no longer any presumed incompetence of women by reason of marriage. *Churchill v. Miller*, 90 Wash. 694, 156 Pac. 851 (1916); *Northern Bank & Trust Co. v. Graves*, 79 Wash. 411, 140 Pac. 328 (1914).

The Washington decisions respecting ultra vires acts of corporations have involved WASH. CONST., art. XII, § 6 forbidding execution of money obligation instruments otherwise than for consideration received. The rule in Washington is that a written obligation in violation of this provision is not enforceable by a non-due-course-holder, but is enforceable by a holder in due course who does not know that the obligation of the corporation is merely an accommodation. *O'Brien v. Turner*, 174 Wash. 266, 24 P.2d 641 (1933); *Bradley Eng'r & Mfg. Co. v. Heyburn*, 56 Wash. 628, 106 Pac. 170 (1910); *Spencer v. Alki Point Transp. Co.*, 53 Wash. 77, 101 Pac. 509 (1909).

<sup>157</sup> Official Comment 6.

<sup>158</sup> *Bair v. Spokane Sav. Bank*, 186 Wash. 472, 58 P.2d 819 (1936); *Walcott v. Wood*, 109 Wash. 617, 187 Pac. 375 (1920); *Cornwall v. Anderson*, 85 Wash. 369, 148 Pac. 1 (1915); *Delta County Bank v. McGranahan*, 37 Wash. 307, 79 Pac. 796 (1905).

<sup>159</sup> *Yakima Valley Bank v. McAllister*, 37 Wash. 566, 79 Pac. 1119 (1905). Cf. *Gibson v. Feeney*, 66 Wash. 531, 120 Pac. 97 (1912) (suggesting that one may deny the execution of a contract and at the same time assert that the contract was procured by fraud).

<sup>160</sup> *Miller v. Williamson*, 128 Wash. 124, 222 Pac. 201 (1924); *Lovell v. Dotson*, 128 Wash. 669, 223 Pac. 1061 (1924); *Lincoln Trust Co. v. Spangler*, 121 Wash. 267, 209 Pac. 521 (1922); 32 YALE L. J. 405 (1923); *Jamieson & McFarland v. Heim*, 43 Wash. 153, 86 Pac. 165 (1906). Of course, the maker cannot defend on the ground that he signed in order to defraud a third person. *Silvain v. Tabusa*, 122 Wash. 443, 210 Pac. 782 (1922).



the policy is usually articulated by legislation, in a provision making non-complying instruments *void*,<sup>161</sup> absence of such a provision usually results in illegality being only a personal defense.<sup>162</sup>

Subsection (2)(d) adds a detail which is not covered by pre-Code law, and it establishes the *real* defense effect of a discharge in bankruptcy.<sup>163</sup> Discharges other than insolvency proceedings are personal.<sup>164</sup>

A caveat seems in order respecting this section, for one must not read it as exclusive. With respect to the defenses of which a holder in due course is freed, it merely states the most general of principles, and detail is left to other Code sections.<sup>165</sup> The listing of real defenses even omits the traditionally real defenses of forgery<sup>166</sup> and material alteration.<sup>167</sup>

<sup>161</sup> Thus, in *Gray v. Boyle*, 55 Wash. 578, 104 Pac. 828 (1909), a due course holder was permitted to recover on an instrument which violated an anti-rebate statute, because that statute did not declare the instrument void. Probably the clearest statement of the effect of the statute is in *Barker v. Sartori*, 66 Wash. 260, 119 Pac. 611 (1911), but the dictum in *Motor Contract Co. v. Van Der Volgen*, 162 Wash. 449, 298 Pac. 705 (1931), 19 CALIF. L. REV. 544 and the decision in *Main v. Johnson*, 7 Wash. 321, 35 Pac. 67 (1893) illustrate the Washington rule.

<sup>162</sup> The gambling transaction is the clearest example. RCW 4.24.090 protects holders in due course, even though as between the parties an instrument is said to be "void and of no effect." *Ash v. Clark*, 32 Wash. 390, 73 Pac. 351 (1903).

Usury, a matter on which there is great variation in state policy, has been held to be a personal defense in Washington. *Harder v. McKinney*, 187 Wash. 457, 60 P.2d 84 (1936); *Acme Fin. Co. v. Zapffe*, 161 Wash. 312, 296 Pac. 1050 (1931); *American Sav. Bank & Trust Co. v. Helgesen*, 64 Wash. 54, 116 Pac. 837 (1911), *aff'd*, 67 Wash. 572, 122 Pac. 26 (1912); *Fenby v. Hunt*, 53 Wash. 127, 101 Pac. 492 (1909); *Grubb v. Stewart*, 47 Wash. 103, 91 Pac. 562 (1907); *Keene v. Behan*, 40 Wash. 505, 82 Pac. 884 (1905); *McDaniel v. Pressler & Anderson*, 3 Wash. 636, 29 Pac. 209 (1892).

In other areas of illegal contracts, language that an obligation is "void as against public policy" must be taken in context, for the language appears in cases where due course holders were not involved. A due course holder might recover on such an instrument even in the face of such strong language. *Doonan v. Rossi*, 112 Wash. 150, 191 Pac. 865 (1920); *Skagit State Bank v. Moody*, 86 Wash. 286, 150 Pac. 425 (1915); *Manson v. Hunt*, 82 Wash. 291, 144 Pac. 45 (1914).

<sup>163</sup> The only Washington decision discovered is *Delta County Bank v. McGranahan*, 37 Wash. 307, 79 Pac. 796 (1905), which upheld the discharge as against the *payee* of a note. Some of the language in that decision, respecting the effect of a discharge order, is questionable. See *Gollehon v. Gollehon*, 178 Wash. 372, 34 P.2d 1113 (1934) for a more accurate statement.

<sup>164</sup> Sections 3-305(2)(e) and 3-602.

<sup>165</sup> *E.g.*, §§ 3-115 [nondelivery of incomplete paper]; 3-119 [effect of collateral writings]; 3-306 [a tabulation of personal defenses]; 3-407 [alteration]; 3-408 [want or failure of consideration]; 3-415 [accommodation signatures]; part 5 of Art. 3 [conditions precedent to liability of secondary parties]; and part 6 of Art. 3 [discharge]. With the exception of the change worked by § 3-115, availability of defenses against due course holders has not been altered by the Code. Illustrative (but not exhaustive) decisions are: *Lee v. Swanson*, 190 Wash. 580, 69 P.2d 824 (1937) (presumption of delivery); *National Fin. Co. v. Emerson*, 117 Wash. 297, 201 Pac. 4 (1921) (failure of consideration is personal defense); *Angus v. Downs*, 85 Wash. 75, 147 Pac. 630 (1915) (nondelivery by the maker is personal defense); *German-American Bank v. Wright*, 85 Wash. 460, 148 Pac. 769 (1915) (conditional delivery is personal defense); *Bradley Eng'r & Mfg. Co. v. Heyburn*, 56 Wash. 628, 106 Pac. 170 (1910) (absence of consideration is personal defense); *Lodge v. Lewis*, 32 Wash. 191, 72 Pac. 1009 (1903) (delivery presumed).

<sup>166</sup> That it is a "real" defense, see § 3-404. On the related question of whether a drawee may charge a drawer's account on a forged instrument, see § 4-401.

<sup>167</sup> Alteration is governed by §§ 3-407 and 4-401.

Availability of set-off and counterclaim is not articulated, though it may be assumed that, as under present law,<sup>168</sup> a holder in due course is insulated from this.<sup>169</sup>

Perhaps the most serious gap at this point in the Code concerns the position of the holder in due course with respect to security given for an obligation which is represented by a negotiable note. With respect to chattel mortgages, Washington has protected the holder in due course in foreclosure as extensively as he would be protected in an action on the note.<sup>170</sup> This protection seems destined to continue under the Code,<sup>171</sup> and indeed will be extended to other types of chattel security, such as the traditional conditional sale.<sup>172</sup>

Section 3-306. RIGHTS OF ONE NOT HOLDER IN DUE COURSE. Unless he has the rights of a holder in due course any person takes the instrument subject to

- (a) all valid claims to it on the part of any person; and
- (b) all defenses of any party which would be available in an action on a simple contract; and
- (c) the defenses of want or failure of consideration, non-performance of any condition precedent, non-delivery, or delivery for a special purpose (Section 3-408); and
- (d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.

Subsection (a) seeks to clarify a point upon which there was a fundamental difference of opinion under prior law. The rule of this subdivision is that any person other than a due course holder, or one

<sup>168</sup> RCW 4.32.110; *Williams v. Duke*, 125 Wash. 250, 215 Pac. 372 (1923); *Bowen v. Rury*, 117 Wash. 30, 200 Pac. 789 (1921). In *Wilson v. Pearce*, 57 Wn.2d 44, 355 P.2d 154 (1960), on the other hand, it was held that a non-due-course-holder is subject to a set off for damages due because of the payee's fraud.

<sup>169</sup> See Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable Instruments Law with Those of Article 3 of the Proposed Commercial Code*, 49 NW. U. L. REV. 417, 436-37 (1954); 72 BANKING L. J. 381, 382-83 (1955).

<sup>170</sup> See Shattuck, *Secured Transactions (Other Than Real Estate Mortgages)—A Comparison of the Law in Washington and the Uniform Commercial Code, Article 9*, 29 WASH. L. REV. 1, 37 (1954) and *Peters v. Gay*, 9 Wash. 383, 37 Pac. 325 (1894).

<sup>171</sup> *Bautista & Kennedy, The Imputed Negotiability of Security Interests under the Code*, 38 IND. L.J. 574, 599 (1963).

<sup>172</sup> Section 9-206.

claiming through a due course holder, takes the paper subject to equitable title claims of third persons. Incidentally, it goes without saying, that such a person is subject to legal defects in title, such as those caused by forged indorsements necessary to the title of the claimant.<sup>173</sup> However, in one situation, involving the effect of maturity, the courts have disagreed.<sup>174</sup> The Washington court's approach was that if an instrument had matured, a subsequent taker would ask, "Why was this not paid?", thereby causing a taker to be subject to the maker's defenses, yet not subject to a third party's rights.<sup>175</sup> The rationale for this approach was that the nonpayment suggested that the maker had a reason not to pay, but did not necessarily suggest that someone other than the maker had a claim to the instrument.<sup>176</sup> The Code rejects this dichotomy and subjects the post-maturity taker<sup>177</sup> to third party claims as well as to a maker's defenses. However, at least one writer has questioned whether the Code will be entirely effective on this point.<sup>178</sup>

There seems to be little doubt that any non-due-course-holder takes negotiable paper subject to the same defenses that were good against his transferor;<sup>179</sup> thus, subdivision (b) does not change prior law.<sup>180</sup>

<sup>173</sup> The very language of subdivision (a) encompasses this, but in addition, one ought to recall that often the rights of parties to negotiable instruments depend upon their being *holders*. If a necessary indorsement is forged or missing, the person in possession of the paper is not the holder as defined in § 1-201(20).

<sup>174</sup> *Harden v. State Bank*, 118 Wash. 234, 203 Pac. 16 (1922).

<sup>175</sup> *Reardan v. Cockrell*, 54 Wash. 400, 103 Pac. 457 (1909).

<sup>176</sup> See Chafee, *Rights in Overdue Paper*, 31 HARV. L. REV. 1104 (1918).

<sup>177</sup> More accurately, of course, it is not a question of maturity but of knowledge of maturity under § 3-302.

<sup>178</sup> Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 481 (1963).

<sup>179</sup> There is always the possibility, however, that one may be precluded, as by estoppel, from asserting a defense. One may, for example, by making representations that no defense exists be precluded from denying those representations as against one who purchased in reliance thereon. *The Old Nat'l Bank v. Exchange Nat'l Bank*, 50 Wash. 418, 97 Pac. 462 (1908). Conduct on the part of an obligor may be such as to suggest that there is, in fact, no defense and that the claimed defense is spurious. *Schields v. Schorno*, 51 Wn.2d 737, 321 P.2d 905 (1958) (payment after knowledge of defenses waives them). Indeed, the total fact pattern is important in determining whether the asserted defense exists, because the business acumen of an obligor may be such as to belie a claimed lack of understanding of the transaction. *Mason v. Burnett*, 126 Wash. 498, 218 Pac. 255 (1923); *Warnock v. Itawis*, 38 Wash. 144, 80 Pac. 297 (1905). Since the availability of a defense is to protect from harm, if the harm has been compensated the defense is done away with. Thus, where a maker of a note has been compensated by the payee for the fraud perpetrated by the payee, the maker will be liable on the note to the holder, even if he does not have due course status. *Nissen v. Obde*, 58 Wn.2d 638, 364 P.2d 513 (1961).

Sometimes, the receipt of benefit by a defendant will nullify a defense, i.e., an ultra vires transaction. *Weber v. Spokane Nat'l Bank*, 64 Fed. 208, (9th Cir., 1894); *United States v. Brooks*, 28 Fed. Supp. 712 (W.D. Wash. 1939); *Flanagan v. American Minerals Prod. Co.*, 108 Wash. 569, 185 Pac. 609 (1909); *Allen v. Olympia Light & Power Co.*, 13 Wash. 307, 43 Pac. 44 (1895); *Tootle v. First Nat'l Bank*, 6 Wash. 181, 33 Pac. 345 (1893).

<sup>180</sup> *Miller v. Myers*, 158 Wash. 643, 291 Pac. 1115 (1930) (one in *pari delicto* to a

Though no specific reference is made to the availability of set-off, the Code produces no change from the view that this remedy is available against non-holders-in-due-course to the same extent that it is available against an assignee.<sup>181</sup>

Subsection (c) emphasizes specific personal defenses which have been recognized under pre-Code law.<sup>182</sup> The greatest difficulty promises to be presented by the provisions which deal with the availability of conditions and delivery for only limited purposes.<sup>183</sup> Problems will arise, as they did under law prior to the Code, respecting the effect of the parol evidence rule. By providing that a non-due-course-holder is subject to the defense of non performance of any condition *precedent*, the Code continues the previous rule that those conditions may be asserted even by parol.<sup>184</sup> No change is suggested in the theory that

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transaction void against public policy may not enforce notes incident thereto); Shuey v. Holmes, 20 Wash. 13, 54 Pac. 540 (1898).

Thus fraud in the inducement is a defense to a claim by one who does not claim through due course holding status. *Shields v. Schorno*, 51 Wn.2d 737, 321 P.2d 905 (1958) (fraud not shown); *Lally v. Johnson*, 187 Wash. 511, 60 P.2d 249 (1936) (fraud not shown); *Bonded Adjustment Co. v. Anderson*, 186 Wash. 226, 57 P.2d 1046, (1936), 106 A.L.R. 166 (non-negotiable instrument); *Community State Bank v. Day*, 126 Wash. 687, 219 Pac. 43 (1923); *Horowitz v. Kuehl*, 117 Wash. 16, 200 Pac. 570 (1921); *Hamilton v. Mihills* 92 Wash. 675, 159 Pac. 887 (1916); *Gwinn v. Ford*, 91 Wash. 498, 158 Pac. 536 (1916), *affirming* 85 Wash. 571, 148 Pac. 891 (1915); *Fournier v. American Life & Acc. Ins. Co.*, 74 Wash. 175, 133 Pac. 9 (1913); *Aurora Land Co. v. Keewan*, 67 Wash. 305, 121 Pac. 469 (1912); *Hynes v. Plastono*, 45 Wash. 190, 87 Pac. 1127 (1906); *Daniel v. Glidden*, 38 Wash. 556, 80 Pac. 811 (1905); *Hanson v. Tompkins*, 2 Wash. 508, 27 Pac. 73 (1891). Duress is similarly treated. *Bair v. Spokane Sav. Bank*, 186 Wash. 472, 58 P.2d 819 (1936); *Delta County Bank v. McGranahan*, 37 Wash. 307, 79 Pac. 796 (1905).

Illegality, though not described as vitiating entirely a note or check, may constitute a personal defense. *Anderson v. Hoard*, 63 Wn.2d 290, 387 P.2d 73 (1963) (usury is a defense on a non-negotiable instrument assigned to the plaintiff); *Lewer v. Cornelius*, 72 Wash. 124, 129 Pac. 911 (1913); *Keene v. Behan*, 40 Wash. 505, 82 Pac. 884 (1905) (usury); *Ash v. Clark*, 32 Wash. 390, 73 Pac. 351 (1903) (gambling debts).

<sup>181</sup> RCW 4.08.080; *Adams v. Spokane Drug Co.*, 57 Fed. 888 (E.D. Wash. 1893); *Wilson v. Pearce*, 57 Wn.2d 44, 355 P.2d 154 (1960); *Johnson v. City of Aberdeen*, 147 Wash. 482, 266 Pac. 707 (1928); *Farmers & Merchants Bank v. Eagon*, 122 Wash. 586, 211 Pac. 278 (1922); For discussion, see *Harrisburg Trust Co. v. Shufeldt*, 87 Fed. 669 (9th Cir., 1898); *Williams v. Duke*, 125 Wash. 250, 215 Pac. 372 (1923).

<sup>182</sup> Failure of consideration or want of consideration: *Spahr v. Liebeck*, 141 Wash. 581, 252 Pac. 107 (1927); *Gunderson v. Green*, 154 Wash. 201, 281 Pac. 731 (1929) [see discussion under § 3-408]; *Americus v. McGinnis*, 128 Wash. 28, 221 Pac. 987 (1924); *Osner & Mehlhorn, Inc. v. Loewe*, 111 Wash. 550, 191 Pac. 746 (1920) [defense not made out]; *Fisk Rubber Co. v. Pinkey*, 100 Wash. 220, 170 Pac. 581 (1918); *Moyses v. Bell*, 62 Wash. 534, 114 Pac. 193 (1911); *Huntington v. Lombard*, 22 Wash. 202, 60 Pac. 414 (1900); *Gordon v. Decker*, 19 Wash. 188, 52 Pac. 856 (1898); *Baker-Boyer Nat'l Bank v. Hughson & Reavis*, 5 Wash. 100, 31 Pac. 423 (1892) (defense not established).

<sup>183</sup> See BRITTON, *BILLS AND NOTES* 121 (2d ed. 1961).

<sup>184</sup> *Mell v. Winslow*, 49 Wn.2d 738, 306 P.2d 751 (1957); *Fleming v. August*, 48 Wn.2d 131, 291 P.2d 639 (1955), 31 WASH. L. REV. 105 (1955); *Walker v. Copeland*, 193 Wash. 1, 74 P.2d 469 (1937); *First Methodist Church v. Soden*, 131 Wash. 228, 229 Pac. 534 (1924); *Dickson v. Protzman*, 123 Wash. 247, 212 Pac. 249 (1923); *Post v. Tamm*, 91 Wash. 504, 158 Pac. 91 (1916); *Morris-Miller Co. v. Von Pressentin*, 63

conditions *subsequent* may not be shown by parol evidence,<sup>185</sup> since the language of the Code is in terms only of conditions *precedent*. The fundamental difficulty remains, however, that the distinction between the two kinds of conditions is, at most, form<sup>186</sup> and, at worst, a fictional device which permit variations in decisions in order to side-step the effect of the parol evidence rule.<sup>187</sup> There are almost certain to be irreconcilable decisions under a rule which permits a signer of an instrument showing absolute liability on its face to show that in reality he was to become liable only on a certain event, but which precludes his showing (even if such were the fact) an understanding that he was not to be liable at all,<sup>188</sup> or that he was liable on a different performance.<sup>189</sup>

Subparagraph (d) appears to be somewhat out of place, since it states what appear to be procedural limitations rather than substantive rights. It seeks to limit to two situations the power, by a holder who has no defense in his own right, to set up a third party's claim. In other words, this means allowing an obligor to say, in effect, "I'm obligated on the instrument, but I ought to pay X and not you." So long as the plaintiff is the holder, the obligor must pay him whether or not some third person has a valid claim to the instrument, unless (a) the case comes within the two situations stated in the statute, or (b) the third person is

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Wash. 74, 114 Pac. 912 (1911). See also the discussion at §§ 3-119, 3-415, and Shattuck, *Contracts in Washington, 1937-1957: Part II*, 34 WASH. L. REV. 345, 382 (1959).

<sup>185</sup> *Fleming v. August*, *supra* note 184; *Whitman Realty & Inv. Co. v. Day*, 161 Wash. 72, 296 Pac. 171 (1931); *Post v. Tamm*, *supra* note 184.

<sup>186</sup> A note may be delivered to become effective only if the Dow Jones averages reach a certain point, or it may be delivered as immediately effective, subject to being aborted if the Dow Jones average does not reach a certain figure. Only the wording is different, for in either situation the figure reached by the Dow Jones averages is precedent to any obligation to perform.

<sup>187</sup> In *Byrne v. Sanders*, 19 Wn.2d 56, 134 P.2d 941 (1943) the payee sued on a note for \$1000 face amount, but the maker was allowed to show that he had signed that note with the understanding that the payee was to determine the actual amount of indebtedness due, and that the amount of liability should equal that figure and no more. Since this indebtedness was \$150, the trial judge erred in not allowing the jury to return a verdict for that sum, according to the supreme court. This opinion cites no authority, does not discuss the parol evidence rule, and seems to be erroneous.

<sup>188</sup> *White v. Armstrong*, 166 Wash. 346, 7 P.2d 12 (1932); *First Methodist Church v. Soden*, 131 Wash. 288, 229 Pac. 534 (1924); *Puget Sound Tel. Co. v. Telechronometer Co.*, 130 Wash. 468, 227 Pac. 867 (1924); *Moore v. Kildall*, 111 Wash. 504, 191 Pac. 394 (1920); *Nat'l Bank v. Becker*, 74 Wash. 431, 133 Pac. 613 (1913); *Pitt v. Little*, 58 Wash. 355, 108 Pac. 941 (1910), 23 YALE L.J. 313 (1914); *Anderson v. Mitchell*, 51 Wash. 265, 98 Pac. 751 (1908); *Hardin v. Sweeney*, 14 Wash. 129, 44 Pac. 138 (1896); *Bryan v. Duff*, 12 Wash. 233, 40 Pac. 936 (1895); *Glenn v. Hill*, 11 Wash. 541, 40 Pac. 141 (1895).

<sup>189</sup> *Blaine v. Darwin*, 160 Wash. 327, 295 Pac. 131 (1931); *Gwinn v. Ford*, 85 Wash. 571, 148 Pac. 891 (1915), *aff'd*, 91 Wash. 498, 158 Pac. 536 (1916); *First Nat'l Life Ass'n Soc'y v. Farquhar*, 75 Wash. 667, 135 Pac. 619 (1913).

The Code does not add to the confusion. See BRANNAN, *NEGOTIABLE INSTRUMENTS* LAW 366-93 (7th ed., Beutel ed. 1948).

See also the related discussion under §§ 3-119 and 3-415.

actually in the suit and setting up his own claim. This, then is the problem involving the availability of *jus tertii* defense to an obligor, and has been artfully discussed elsewhere.<sup>190</sup> Unfortunately, the Washington decisions are difficult to pinpoint on this issue, and it can only be concluded that they have failed to manifest any clearcut policy. In some instances, obligors have successfully asserted third party rights in order to block a plaintiff's recovery.<sup>191</sup> On the other hand, some decisions have inferred that only the holder of the outstanding claim may assert it.<sup>192</sup> Unlike these decisions, the Code is consistent throughout and permits an obligor to pay the holder in performance of his contract even with knowledge of outstanding claims, where subsection (d) precludes his use of those claims defensively.<sup>193</sup>

Section 3-307. BURDEN OF ESTABLISHING SIGNATURES, DEFENSES AND DUE COURSE. (1) Unless specifically denied in the pleadings each signature on an instrument is admitted. When the effectiveness of a signature is put in issue

- (a) the burden of establishing it is on the party claiming under the signature; but
- (b) the signature is presumed to be genuine or authorized except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required.

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<sup>190</sup> BRITTON, *BILLS AND NOTES* 462-77 (2d ed. 1961).

<sup>191</sup> *Westcott v. Donion*, 137 Wash. 78, 241 Pac. 658 (1925) (apparently permits a maker to defend on the basis of the rights of a creditor of the payee where the payee indorsed to the plaintiff in fraud of creditors); *Young v. American Can Co.*, 131 Wash. 374, 230 Pac. 147 (1924); *Gross v. Bennington*, 52 Wash. 417, 100 Pac. 846 (1909). In this last cited case, the defendant had executed a note payable to a railroad, which had indorsed it over to X and eventually it was transferred to the plaintiff. There was evidence of the propriety and validity of the indorsement by the railroad (payee), but the court said that it was still possible that the maker could show that the assignment by one of the transferors was *fraudulent*. Under the Code, it could be shown that bearer paper was *stolen*, but not that it was transferred through fraudulent inducement. Obviously, under the Code as under prior law, the victim of the fraud could assert his own claim, and under § 3-306(a) this claim would be superior to that of a holder other than one in due course.

<sup>192</sup> *Miller v. Williamson*, 128 Wash. 124, 222 Pac. 201 (1924) (the defending maker was not permitted to show that the payee had indorsed the instrument over to the plaintiff without authority); *Thomson v. Koch*, 62 Wash. 438, 113 Pac. 1110 (1911) (in a suit by the transferee against the maker it constitutes no defense that the paper was endorsed and discounted under a usurious contract at an unlawful rate of interest); *Lodge v. Lewis*, 32 Wash. 191, 72 Pac. 1009 (1903); *Seattle Nat'l Bank v. Emmons*, 16 Wash. 585, 48 Pac. 262 (1897); *Allen v. Olympia Light & Power Co.*, 13 Wash. 307, 43 Pac. 55 (1895).

<sup>193</sup> Section 3-603. See Leary, *Commercial Paper: Article III*, 16 ARK. L. REV. 33, 42 (1961).

- (2) When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense.
- (3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course.

The three subdivisions of this section suggest a rough outline of the critical issues in a suit on a negotiable instrument: (1) Was the instrument executed by the defendant or by another authorized by the defendant? (2) Does the defendant have a sufficient reason for not paying? (3) Is that reason one which is not valid against a due course holder, and is the plaintiff a due course holder? Although an actual law suit may not unfold in this way,<sup>194</sup> this order of stating the issues corresponds to the order in which the trier of facts will have to unravel the case.

Subdivision (a) is new and requires a word of caution. It deals with forged or unauthorized signatures, and the caveat is that this issue may arise in a number of ways, only one of which seems to be governed by this section. By way of illustration, consider those cases in which a drawee bank has paid a check, charged the drawer's account, and then has discovered that the drawer's signature was forged, or that an indorsement was forged. The court action will probably be one by the drawer to require the drawee to recredit his account for the questionable item. In such an action, which party bears the burden of establishing the forgery?

Literally read, the Code section presently under discussion would place the burden of establishing validity upon the drawee bank, since the drawee bank is the party which is relying on the signature. With one exception,<sup>195</sup> the Washington decisions<sup>196</sup> and text authority<sup>197</sup> have been to the contrary under prior law. (The Code probably will not be construed to change the rule of these decisions, because the location of this section, coupled with the wording of the Official Comments, suggests that the posture of the case is significant.) Thus, this section

<sup>194</sup> Lynn, *Article 3 of the Uniform Commercial Code*, 23 OHIO ST. L.J. 219, 233 (1962).

<sup>195</sup> Crane v. Dexter Horton & Co., 5 Wash. 479, 32 Pac. 223 (1893).

<sup>196</sup> Denbigh v. First Nat'l Bank, 102 Wash. 546, 174 Pac. 475 (1918); Buell v. Aberdeen State Bank, 58 Wash. 407, 108 Pac. 951 (1910).

<sup>197</sup> 2 PATON'S DIGEST 1837 (1942).

appears to apply only where a person is attempting to enforce payment, and not where, as in the cases cited, the suit is to cancel out a payment already made. Similarly, it seems that this section would apply in an action to establish liability for breach of warranty of title, in the forged indorsement pattern.<sup>198</sup> In these cases, it is believed that the *plaintiff* should bear the burden of showing the breach of warranty, and that this would require him to establish the forgery.

The Washington decisions on forged or unauthorized signatures can be characterized as contrary to the Code rule, though they have not been overly precise.<sup>199</sup> They have, however, been consistent with the underlying assumption made by the codifiers that forgeries are unusual; indeed, they are so unusual that at least the burden of going forward with the evidence rests on the person asserting that a forgery exists.<sup>200</sup> Thus these Washington decisions are harmonious with the idea that the one claiming a forgery must, in the first instance, introduce some evidence to support his contention.<sup>201</sup> The nature of the evidence required is not specified by the Code, but it is often entirely circumstantial.<sup>202</sup> With respect to the Codes' requirement that the pleadings must specifi-

<sup>198</sup> Section 3-417.

<sup>199</sup> For example, in *Lanza v. Hillman's Estate*, 194 Wash. 694, 79 P.2d 643 (1938), the findings of the trial court that a signature was authentic were sustained, even though the evidence on the point was evenly balanced. Under the Code, it would appear that even balance of the evidence would defeat recovery by a holder.

In *National City Bank v. Shelton Elec. Co.*, 96 Wash. 74, 164 Pac. 933 (1917), there is specific language that once the plaintiff showed that certain signatures were authentically those of officers of the defendant, and that the dates were such as to fall at a time during the tenure of office of those officers, the burden of convincing the jury that the signatures were unauthorized rested on the defendant. The Code, just as did the NIL, provides a basis for at least part of this allocation of the burden, for under § 3-114(3) the dates of the instrument are presumed to be correct. Thus if the defendant is asserting that the signers were not authorized to bind it because (a) the instruments were signed at a time other than shown by the date and (b) at a time when the signers were not authorized, the burden of overcoming the effect of the presumption of proper date, at least in the sense of going forward with the evidence, rests on the defendant under § 1-201(31).

In *Yakima Valley Bank v. McAllister*, 37 Wash. 566, 79 Pac. 1119 (1905), however, the rule adopted accords with the Code's rule.

<sup>200</sup> *Kilbourne v. Rathbun*, 91 Wash. 121, 157 Pac. 457 (1916); *Fishburne v. Robinson*, 49 Wash. 271, 95 Pac. 80 (1908); *Yakima Nat'l Bank v. Knipe*, 6 Wash. 348, 33 Pac. 834 (1893).

<sup>201</sup> Once some evidence is introduced to support the claim of forgery, the presumption of genuineness disappears. Official Comment 1. This, in general, accords with previous authority on the effect of the NIL's presumptions. *Nicholson v. Neary*, 77 Wash. 294, 137 Pac. 492 (1914).

<sup>202</sup> In *Moore v. Palmer*, 14 Wash. 134, 44 Pac. 142 (1896), the plaintiff sued on a \$20,000 note and was met by the defense that the note was either a forgery or had been obtained (from the deceased maker) by trickery. A jury verdict for the defendants was sustained, because plaintiff was shown to have been of very limited means, to have borrowed money from the defendant and given his note, which was inconsistent with his claim that he held a \$20,000 note bankable at any Seattle bank. On the other hand, in *Taylor v. Gale*, 14 Wash. 57, 44 Pac. 110 (1896), the defendant (maker) of the notes contended that they were forged, and sought to prove this by showing that sometime



cally deny the signature in order to raise the forgery issue, there is no previous Washington authority.<sup>203</sup>

Subsection (2) clarifies, without changing prior law, the allocation of the burden of proof for asserted defenses. While the burden is on the plaintiff to establish conditions precedent to the defendant's liability, (*i.e.* presentment, dishonor, notice and protest)<sup>204</sup> it is incumbent on the defendant to convince the trier of fact that a defense exists.<sup>205</sup> Illustrative are Washington decisions which require that the defendant establish want or failure of consideration,<sup>206</sup> fraud,<sup>207</sup> duress,<sup>208</sup> usury,<sup>209</sup> conditional delivery or liability,<sup>210</sup> and payment.<sup>211</sup>

The Washington rule with respect to the allocation of the burden of

prior to the dates of the notes he had received a substantial inheritance. The court held that such evidence was erroneously admitted, since men execute notes whether or not impecunious.

In *Moore v. Palmer*, *supra*, evidence was submitted to the jury that the deceased maker had referred to the plaintiff as a "jack-leg lawyer," because this rebuts the plaintiff's contention that the note was given for legal services.

Usually, the evidence is more conventional, consisting of professional or lay testimony about the authenticity of the specific signature. *Poncin v. Furth*, 15 Wash. 201, 46 Pac. 241 (1906); *Moore v. Palmer*, *supra*.

<sup>203</sup> *Cf.* *Tullis v. Shannon*, 3 Wash. 716, 29 Pac. 449 (1892), where a general denial was held to put the plaintiff to proof of his ownership.

<sup>204</sup> *Bay View Brewing Co. v. Grubb*, 24 Wash. 163, 63 Pac. 1091 (1901).

<sup>205</sup> *Metzger v. Sigall*, 83 Wash. 80, 145 Pac. 72 (1914); *Clark v. Eltinge*, 34 Wash. 323, 75 Pac. 866 (1904).

<sup>206</sup> *Delegan v. White*, 59 Wn.2d 510, 368 P.2d 682 (1962); *Dittmar v. Frye*, 200 Wash. 708, 93 P.2d 716 (1939); *Dittmar v. Frye*, 200 Wash. 451, 93 P.2d 709 (1939); *O'Brien v. Turner*, 174 Wash. 266, 24 P.2d 641 (1933); *Building Materials, Inc. v. Electric Equip. & Eng'g Co.*, 166 Wash. 573, 7 P.2d 601 (1932); *Morisse v. Salvesen*, 165 Wash. 157, 4 P.2d 252 (1931); *West & Wheeler v. Longtin*, 118 Wash. 575, 204 Pac. 183 (1922); *Woodland State Bank v. McKean*, 118 Wash. 451, 203 Pac. 939 (1922); 22 COLUM. L. REV. 481; *Spokane State Bank v. Pitner*, 114 Wash. 177, 194 Pac. 969 (1921); *State Bank v. Morrison*, 85 Wash. 182, 147 Pac. 875 (1915); *Lyts v. Keevey*, 5 Wash. 606, 32 Pac. 534 (1893); *McKenzie v. Oregon Imp. Co.*, 5 Wash. 409, 31 Pac. 748 (1892); *Baker-Boyer Nat'l Bank v. Hughson & Reavis*, 5 Wash. 100, 31 Pac. 423 (1892).

<sup>207</sup> *Olympia Credit Bureau v. Smedegard*, 40 Wn.2d 76, 241 P.2d 203 (1952); *Westcott v. Donion*, 137 Wash. 78, 241 Pac. 658 (1925). Literally read, the Code rejects the requirement found in Washington decisions that fraud must be proved by "clear, cogent and convincing evidence," since the definition of "burden of establishing" is less onerous Section 1-201(8).

<sup>208</sup> *Whitman Realty & Inv. Co. v. Day*, 161 Wash. 72, 296 Pac. 171 (1931); *Cornwall v. Anderson*, 85 Wash. 369, 148 Pac. 1 (1915). On the requirement of "clear and satisfactory" evidence, see the preceding footnote.

<sup>209</sup> *Neeser v. Martin*, 54 Wn.2d 66, 337 P.2d 1065 (1959); *Gill v. Strouf*, 5 Wn.2d 426, 105 P.2d 829 (1940); *McCall v. Smith*, 184 Wash. 615, 52 P.2d 338 (1935); *Arnot v. Fischer*, 161 Wash. 67, 295 Pac. 1117 (1931); *Bovee v. Yamamoto*, 121 Wash. 517, 209 Pac. 697 (1922); *Washington Fire Ins. Co. v. Maple Valley Lumber Co.*, 77 Wash. 686, 138 Pac. 553 (1914); *Brundage v. Burke*, 11 Wash. 679, 40 Pac. 343 (1895).

<sup>210</sup> *Downie v. Cooledge*, 48 Wn.2d 485, 294 P.2d 926 (1956); *Doonan v. Rossi*, 112 Wash. 150, 191 Pac. 865 (1920); *Elwell v. Turney*, 39 Wash. 615, 81 Pac. 1047 (1905).

<sup>211</sup> *Rushlight v. McLain*, 28 Wn.2d 189, 182 P.2d 62 (1947); *Federal Rubber Co. v. M. M. Stewart Co.*, 180 Wash. 625, 41 P.2d 158 (1935); *Creditors Ass'n v. Fry*, 179 Wash. 339, 37 P.2d 688 (1934); *Thorpe v. Hovick*, 134 Wash. 249, 235 Pac. 14 (1925); *Blaser v. Meeker*, 125 Wash. 379, 216 Pac. 1 (1923).

proof on the issues of authority *vel non* to bind the defendant has been stated as follows:

Where agency is denied altogether, the burden is upon the party alleging agency to prove it; but where . . . an agency to deal with the particular subject of the inquiry is alleged or admitted, and a special limitation is relied upon to avoid liability for certain of the agent's acts concerning the matters with which he is authorized to deal, the burden is upon the party asserting the special limitation to prove it.<sup>212</sup>

The defenses of improper completion and alteration are treated as aspects of one generic defense under the Code.<sup>213</sup> In *Ladd & Tilton Bank v. Small*,<sup>214</sup> the defendant had signed checks in blank and placed them in another's hands, and it was held that, under NIL section 59, the defendant had become bound on the instrument prior to the acquisition of defective title. It was therefore not incumbent upon the plaintiff to prove that he was a due course holder. This analysis seems incorrect, since the initial obligation on the instrument arose on completion and not before. Thus, if defendant were to show a lack of authority to complete the instrument, recovery would be precluded unless the plaintiff is able to show that he holds in due course.

As a matter of first impression, one would assume that the burden of proof to show alteration on an instrument should be upon the defendant, and some of the early decisions have so held.<sup>215</sup> There is doubt whether this is true in every case,<sup>216</sup> and even greater doubt where the alteration is obvious.<sup>217</sup> The Washington rule, when an alteration is obvious, requires the plaintiff to prove that no alteration had occurred.<sup>218</sup> While the probable impact of the Code will be to change this rule,<sup>219</sup> no prediction is entirely safe.<sup>220</sup>

Subsection (3) covers the burden of proof on the issue of *due course* holding. However, before an analysis is undertaken, it must be observed that demonstrating the validity of all necessary signatures may not establish the plaintiff as the *holder* of the instrument. Suppose, by

<sup>212</sup> *Mott Iron Works v. Metropolitan Bank*, 78 Wash. 294, 139 Pac. 36 (1914); *accord*: *McKinley v. Mineral Hill Consol. Mining Co.*, 46 Wash. 162, 89 Pac. 495. (1907); *Stinson v. Sachs*, 8 Wash. 391, 36 Pac. 287 (1894).

<sup>213</sup> See § 3-407.

<sup>214</sup> 126 Wash. 8, 216 Pac. 862 (1923).

<sup>215</sup> *Yakima Nat'l Bank v. Knipe*, 6 Wash. 348, 33 Pac. 834 (1893); *Wolfman v. Bell*, 6 Wash. 84, 33 Pac. 834 (1893).

<sup>216</sup> BRITTON, *BILLS AND NOTES* § 287 (2d ed. 1961).

<sup>217</sup> BRADY, *BANK CHECKS* 442 (3rd ed. 1962).

<sup>218</sup> *Lembo v. Federici*, 62 Wn.2d 972, 385 P.2d 312 (1963), 39 WASH. L. REV. 228 (1964).

<sup>219</sup> BRADY, *op. cit. supra* note 217.

<sup>220</sup> See discussion in 39 WASH. L. REV. 228 (1964).

way of illustration, that an instrument is payable on its face to the order of *A*, and *A* has indorsed "Pay to *B*." The signatures of the maker and of *A* are valid, but if the instrument is in the hands of *C*, there is technically no holder, as defined by the Code.<sup>221</sup> At this point, if *C* is to be able to recover on the instrument, he must establish additional facts that explain why he is the one to be paid.<sup>222</sup> An illustrative case under prior law is *Stinson v. Sacks*.<sup>223</sup> Here the maker contended that the plaintiff was not the indorsee or payee (or bearer of bearer paper), rather the actual payee was an agent of plaintiff. If this were true, the principal could sue on the instrument, though it was payable to the agent, without an indorsement from the agent, since the principal is the owner of the document. The Code would be to the same effect.

Once it is shown that the plaintiff should be able to recover as a holder, or as one having the holder's rights, and the defendant has shown a personal defense, the issue of due course holding becomes critical. On this issue, the burden of proof is upon the plaintiff under both the Code and prior law.<sup>224</sup> However, the Code clarifies some points which were previously uncertain. First, the proof of any defense places the proof of due course holding upon the plaintiff;<sup>225</sup> Second, this burden requires that the plaintiff establish all the elements of due course holding.<sup>226</sup> These requirements place a rather ticklish burden on the

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<sup>221</sup> "'Holder' means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank." Section 1-201(20).

Under this definition, *B*, the special indorsee, and *A*, the payee, are not holders, since they are not in possession. *C*, who is in possession, is not the holder because the instrument is not payable to him, to his order, or to bearer.

<sup>222</sup> Official Comment 2.

<sup>223</sup> 8 Wash. 391, 36 Pac. 287 (1894).

<sup>224</sup> RCW 62.01.059 [NIL § 59].

<sup>225</sup> Decisions under prior law were uncertain where the defense asserted was want or failure of consideration. There is authority in Washington that proof of these defenses will require plaintiff, if he is to recover, to carry the burden of proof on the issue of due course holding. *Great W. Land & Improvement Co. v. Sandygren*, 141 Wash. 451, 252 Pac. 123 (1927) (dissenting opinion); *National City Bank v. Shelton Elec. Co.*, 96 Wash. 74, 164 Pac. 933 (1917). Other authority is that in such instances, the defendant, even though he has shown his defense of lack or failure of consideration, still must pay, unless he further shows that the plaintiff is *not* one having the rights of an holder in due course. *First Nat'l Bank v. Moore*, 148 Fed. 953, (9th Cir. 1906); *Stevens v. Selvidge*, 103 Wash. 683, 175 Pac. 294 (1918); *German-American Bank v. Wright*, 85 Wash. 460, 148 Pac. 769 (1915); *Moyses v. Bell*, 62 Wash. 534, 114 Pac. 193 (1911).

<sup>226</sup> There is no doubt, except for exceptions stated in the previous footnote, that the plaintiff must establish his due course holding. *Nissen v. Obde*, 55 Wn.2d 527, 348 P.2d 421 (1960); *Bowles v. Billik*, 27 Wn.2d 629, 178 P.2d 954 (1947), 23 WASH. L. REV. 74 (1948); *Higgins v. Radach*, 12 Wn.2d 628, 123 P.2d 352 (1942); *Spokane Sec. Fin. Co. v. DeLano*, 168 Wash. 546, 12 P.2d 924 (1932); *Gottstein v. Simmons*, 59 Wash. 178, 109 Pac. 596 (1910); *City Nat'l Bank v. Mason*, 58 Wash. 492, 108 Pac. 1071 (1910); *Cedar Rapids Nat'l Bank v. Myhre Bros.*, 57 Wash. 596, 107 Pac. 518 (1910). But there is doubt as to whether *all* of the elements must be shown. The Code seems to settle this question by its precise wording in a way rejecting those de-

plaintiff, since he is often required to prove a negative—*i.e.* that he did not take in bad faith. Since testimonials on this issue by the plaintiff or his agent are often pious sounding, there is substantial doubt as to whether these self-serving bits of testimony must be accepted as true if uncontradicted.<sup>227</sup> Some authority exists in Washington which darkly hints that the testimony of partisans is more likely false than true.<sup>228</sup> An appropriate rule would seem to be that credibility of witnesses, however prejudiced, is for jury determination.<sup>229</sup> Where unchallenged nonpartisan testimony exists to the effect that a plaintiff is a due course holder, a directed verdict for the plaintiff is even warranted.<sup>230</sup>

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cisions to the effect that once the plaintiff shows that he took for value and in ordinary course of events, the burden is then upon the defendant to show bad faith. *Lovering v. Pacific Fruit Package Co.*, 162 Wash. 445, 298 Pac. 693 (1931); *Fisk Rubber Co. v. Pinkey*, 100 Wash. 220, 170 Pac. 581 (1918). Washington decisional authority consistent with the Code, however, is not lacking. *Ireland v. Scharpenberg*, 54 Wash. 558, 103 Pac. 801 (1909).

<sup>227</sup> BRITTON, *BILLS AND NOTES* § 105 (2d ed. 1961).

<sup>228</sup> *Gosline v. Dryfoos*, 45 Wash. 396, 88 Pac. 634 (1907).

<sup>229</sup> *Yakima Valley Bank v. Churchill*, 131 Wash. 45, 228 Pac. 1009 (1924); *National Fin. Co. v. Emerson*, 117 Wash. 297, 201 Pac. 4 (1921); *Washington Trust Co. v. Keyes*, 88 Wash. 287, 152 Pac. 1029 (1915); *American Sav. Bank & Trust Co. v. Helgesen*, 64 Wash. 54, 116 Pac. 837 (1911), *aff'd*, 67 Wash. 572, 122 Pac. 26 (1912); *Scandinavian Am. Bank v. Johnston*, 63 Wash. 187, 115 Pac. 102 (1911).

<sup>230</sup> *Angus v. Downs*, 85 Wash. 75, 147 Pac. 630 (1915); *McLaughlin v. Dopps*, 84 Wash. 442, 147 Pac. 6 (1915). Conversely, the plaintiffs evidence may be insufficient as a matter of law. *Gunderson v. Green*, 154 Wash. 201, 281 Pac. 731 (1929).